SUPREME COURT, U. S.
JUN 19 1967
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

October Term, 1967
No. 265

CHARLES TOWN, Incorporated,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit.

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Opinions Below.

The memorandum findings of fact and opinion of the Tax Court (Appendix, *infra*, beginning at p. 17 thereof) was officially reported as T.C. Memo. 1966-15, and appears in the Commerce Clearing House "TCM" reports at 25 TCM 77. The opinion of the Court of Appeals (Appendix, *infra*, beginning at p. 1 thereof) is reported at 372 F. 2d 415.[1]

Jurisdiction.

The judgment of the Court of Appeals was entered on January 31, 1967. [R. 27.][2] On February 27, 1967,

[1]The appendix to this petition contains the opinion of the court below; also, without omission, the contents of Insert I and Insert III of the certified transcript of record sent up to this Court, in other words, the entire appendices to petitioner's briefs in the court below, including the findings and opinion of the Tax Court.

[2]The "R." references are to the indicated pages in the certified transcript of record.

the time for filing in said court petition for rehearing was extended to and including March 17, 1967. [R. 32.] Petition for rehearing was filed March 13, 1967. [R. 33.] The said petition was denied March 23, 1967. [R. 40.] The jurisdiction of this Court is based on 28 U.S.C. §1254(1).

Question Presented.

The question presented is whether, under the facts as found by the Tax Court, the Commissioner of Internal Revenue, pursuant to Section 482 of the Internal Revenue Code of 1954, properly allocated to petitioner, which conducted two race meeting ventures, income received by another corporation from the said ventures as its contractual share of the profits thereof for the use and risk of money furnished by it.

Statutes and Regulations Involved.

The statutory provision applied by the Tax Court and the Court of Appeals here is Section 482 of the Internal Revenue Code of 1954, reading as follows:

> "§482. Allocation of income and deductions among taxpayers.
>
> "In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses."

Respondent, as the Court of Appeals notes, also relied on Section 61 of that Code. (App. 2.)[3]

As to related Treasury regulations, both courts below set out by footnote the full text of Section 1.482-1(c). It is quoted as part of their opinions in the Appendix hereto. (App. 8, 63.) The Court of Appeals, however, as shown in the Appendix hereto (App. 9), also cited and quoted from Section 1.482-1(a)(3) of those regulations.

Statement.

This is an income tax case. The Tax Court sustained the action of respondent, the Commissioner of Internal Revenue, in allocating to petitioner, Charles Town, Incorporated, hereinafter referred to as "Charles Town," income reported by another corporation, Fairmount Steel Corporation, hereinafter referred to as "Fairmount." The Court of Appeals affirmed.

The tax years of petitioner involved are fiscal years ended November 30, 1958, and November 30, 1959. As stated by the Court of Appeals, the "Commissioner's allocation under Section 482 [was] predicated on the alleged shifting of profits from one controlled entity (Charles Town) to another (Fairmount) for the purpose of utilizing net operating loss carryovers of the latter." (App. 1-2.) Fairmount, as the court below also stated, was controlled at all relevant times by two brothers, Ben and Herman Cohen. They also controlled other business enterprises including Housing

[3]The "App." references are to the pages of the Appendix hereto, without regard to the numbers of the pages from which derived.

Engineering Corporation and C. B. Associates, a partnership which succeeded Housing Engineering Corporation upon its liquidation in April 1958. (App. 3.) Whether, under the facts as found by the Tax Court, the relation of the Cohen brothers to Charles Town at the relevant time constituted control of that entity also, presents one of the problems in this case.

Charles Town was incorporated in West Virginia for the purpose of operating a race track. (App. 24.) The West Virginia Racing Commission in May 1958 had issued an ultimatum to one Mrs. Boyle, owner of a race track in the city of Charles Town, that if a summer meet were not operated on that track it would take her license away. On May 20 she executed a lease of the track, for the period May 22, 1958, to September 10, 1958, to "Ben Cohen, acting for Charles Town, Incorporated, a corporation to be hereinafter created under the laws of the State of West Virginia." (App. 23.) Fairmount gave Mrs. Boyle at the same time a check for the agreed rental of $225,000. On May 22, 1958, it gave her an additional $15,000 pursuant to supplemental agreement entered into on that date. (App. 26.)

On that date, also, Charles Town, the corporation, was incorporated. Pursuant to previous subscription (App. 81), it then issued 100 shares at $10 each, one each to Ben and Herman Cohen and the other 98 to Louis Pondfield (App. 24), a first cousin of the Cohens who had been connected with horse racing since 1920 and had been a manager of racing meets since 1949. (App. 21, 71-72.)

In its application to the Racing Commission for a license Charles Town disclosed, in response to a question therein as to what persons had, other than as shareholders, "advanced, by loan or otherwise, the capital invested in the business," that such person was Fairmount and that the amount of capital so advanced was $500,000. (App. 36, 80.) The Commission was also at the same time informed that Pondfield would manage the meet. (App. 87-88.)

On May 20, 1958, concurrently with the execution of the lease on that date, an agreement was entered into between Fairmount and Charles Town. Under said agreement Fairmount agreed to provide "all monies necessary" for operating the meet, and in a minimum amount of $450,000, and Charles Town agreed to operate the meet. (App. 30-31.) The agreement further provided that Charles Town would get 10 per cent of the profits "for its services" in such operation, and Fairmount would get the other 90 per cent for its said financing of the meet and would bear entirely any loss. It was executed on behalf of Fairmount by Herman Cohen and on behalf of Charles Town by Pondfield. Also, pursuant to the agreement, Ben and Herman Cohen were placed on the board of directors of Charles Town, for "so long as Charles Town shall be indebted to Fairmount"; and they were empowered as the board majority "to make all major decisions as to the allocation of income and expenses and in the management of the race meet." (App. 29-32.) This was done to protect the funds advanced by Fairmount against misuse by Pondfield. (App. 74.) Moreover, the Cohens did not interfere in his management of the meet. (App. 73.)

Under an identical but subsequent and entirely separate agreement, expressly approved by Pondfield as well as the Cohens (App. 84-85), a second racing meet was conducted, during the period November 20, 1958, to February 20, 1959. In the case of each meet each sum advanced by Fairmount was advanced by it for a specified use in connection with that meet. For each meet, also, the advances so made consisted almost entirely of just two items, the rent, and "bankroll," the latter being the money necessary to be on hand to start a day's wagering operations. (App. 27-28, 67-68, 75-76.)[4]

The income from the racing meets was divided by the two entities in accordance with their agreement and was so reported on their income tax returns. (App. 6, 45-46.) There is clear and uncontradicted testimony that the division between them was fair, that it was, in fact, just what one would expect between parties dealing at arm's length, as evidenced by meets operated by Pondfield when the Cohens were not involved. (App. 74.) There is absolutely no evidence and no finding to the contrary. The "operation" in the case of each racing meet was the only duty assumed by Charles Town in its respective contract with Fairmount; the entire

[4]The total actually advanced by Fairmount for the first meet, all of it advanced in May 1958 and repaid in full by August 9, 1958, was $479,025.00; and the total actually advanced by Fairmount for the second meet, all of it advanced in November and December, 1958, and repaid in full by February 10, 1959, was $507,500.00. (App. 26-27, 67-68.) The Tax Court and the Court of Appeals added those two sums together, disregarding the intermediate repayment of the first sum, so as to derive as made "available" by Fairmount to Charles Town a total of $986,525.00 (App. 5, 58)—this for the purpose of relating to it as a "like" amount, and therefore as its source, a sum of $900,000.00 received by Fairmount from Housing in March 1958. (App. 3, 58.) However, we base no contention on this bizarre piece of logic.

financing, and the entire bearing of any loss, were the duties correspondingly and expressly assumed by Fairmount. (App. 30-31.) There is a finding by the Tax Court that the total net income from the "operation" of the two racing meets was produced and earned by Charles Town. (App. 52.) There is no finding that the total net income attributable to performance by both parties, in other words, to the operation, *and the entire financing and bearing of any loss,* was produced and earned by Charles Town. The Commissioner, nevertheless, sustained by the courts below, treated the entire income from each racing meet as the income solely of Charles Town. (App. 15.)

Reasons for Granting the Writ.

1. The decision below is in clear conflict with the decision of the Ninth Circuit in *Rooney v. U.S.*, 305 F. 2d 681. The opinion below takes the form of quoting from that case, agreeing with it, and then distinguishing it. (App. 9.) But the attempted distinction, on the very face of the opinion below, merely confirms and emphasizes the conflict.

In *Rooney* it was held, 305 F. 2d at page 683, as quoted by the court here below, that common control, to require application of Section 482, must exist "when the taxpayers deal with each other." It was there also held, at the same page, that "control at another time is unimportant." Also, these holdings there were necessary to the decision there.

Obviously, then, under the holding in that case, as a requisite to the application of Section 482 the common control must have existed here when each agreement

between Fairmount and Charles Town was made. Therefore, it could not be based upon that same agreement.

Now, as to the first agreement, the opinion below, to show that the common control was not based by it upon that agreement, says that that agreement was "only one of several facts . . . by which their [the Cohens'] actual and effective control of the corporation was acquired and exercised." (App. 9-10.) In direct conflict, however, it then recites as the facts referred to a "course of events," *including "the execution of the agreement"* (italics supplied), none of which except the agreement itself could have given them any control over Charles Town, 98 per cent of the stock of which was owned by Pondfield.

The Court of Appeals next attempts to avoid that effect by suggesting that even if the Cohens were not, at the relevant time, in control of Charles Town, they were then in control of "the *business* known as Charles Town, Incorporated." (App. 10, italics in original.) But the entity to which the income was allocated under Section 482 is the petitioner here, the *corporation*. The control required is therefore clearly of the corporation, not the "business."

Finally, the opinion then says (App. 10), "Pondfield *gave up* the control he could have exercised as majority stockholder when he permitted Charles Town" (italics supplied) to enter into the agreement. There again the opinion itself makes clear that, except for the agreement, and to the extent of the agreement, the control of Charles Town was not in the Cohens, it was in Pondfield.

The same reasoning applies to the second agreement, since the first agreement, by its express terms, applied only to the one meet. (App. 29-32.) That was obviously why, when the second meet was agreed upon, Pondfield as well as the Cohens approved it. (App. 84-85.) So again, except for the agreement, and to the extent of the agreement, the Cohens had no control of Charles Town.

Thus the opinion below, on its face, in attempting to distinguish the *Rooney* case, shows all the more clearly that it is in direct conflict with that case, that the situation here fails to meet the requirement of that case that the common control exist "when the taxpayers deal with each other."

2. The decision below is also in clear conflict with that of the Tenth Circuit in *Davis v. United States*, 282 F. 2d 623. That case involved Section 45 of previous internal revenue law, the forerunner, without substantial change, of present Section 482. As that case shows, at page 627, the section cannot be applied, even if there is common control, if the division of the income between the entities is what it would have been "had they been dealing at arm's length." To the same effect are the following cases, in which, as in *Davis*, there was common control, but which were decided for the Commissioner because, in addition, the division of the income between the entities involved was found not to be what it would have been had they been dealing at arm's length: *National Carbide Corp. v. Commissioner*, 336 U.S. 422, 438; *South Texas Rice Warehouse Co. v. Commissioner* (C.A. 5), 366 F. 2d 890, 897, cert. denied, April 24, 1967; *Oil Base, Inc. v. Commissioner* (C.A. 9), 362 F. 2d 212, 214, cert. denied, Nov. 7,

1966; *Eli Lilly & Co. v. U.S.* (Ct.Cls.), 372 F. 2d 990, 1000. To the same effect are the related Treasury regulations. (App. 8, fn. 4, last sentence.) The *Davis* case also shows, at page 627, that the fact that Fairmount here was able to offset its own net operating losses against the income from the meets is wholly irrelevant.

There is here no finding, nor a single scintilla of evidence to support a finding, that the share of the income received by Fairmount was not fair and just compensation to it for the use and risk of the money furnished by it. The clear evidence to the contrary, showing that the division of the income between Fairmount and Charles Town was in accord with experience in the case of parties dealing at arm's length (App. 74), is wholly uncontradicted.

There is also no finding as to what fair and just compensation to Fairmount for the use and risk of the money furnished by it should be, if not the amount which it received. There is not even a finding that the evidence was inadequate for that purpose.

We submit, therefore, that the decision below is in clear conflict with the decision of the Tenth Circuit in *Davis, supra.*

3. This case is important because it presents, on its face, a clear denial of the due process of law required by the Fifth Amendment.

Under each of the two contracts between Fairmount and Charles Town, the funds were advanced by Fairmount for a specific short-term purpose, a single racing meet, and only for the period of the meet, and only, moreover, for specified uses in connection with the meet.

Fairmount furnished the use and risk of the money, and Charles Town the operation. And in substance, each contract was one between the Cohens, on the one side, as owners of Fairmount, and Pondfield, on the other side, as the owner of Charles Town, and therefore clearly at arm's length. Indeed, the court below concedes they were at arm's length, for it says that the reason, in its view, why the clauses requiring Fairmount to bear entirely any loss were inserted in each contract was "to prevent Fairmount from charging back any of its capital losses against Charles Town." (App. 14.)

In that situation to charge Charles Town with tax on the share of the income belonging to, and received by, Fairmount, is a plain violation of due process. As this Court held in *Hoeper v. Tax Commission*, 284 U.S. 206, it is a violation of due process to tax the income of one person to another, even though they be as closely related as husband and wife. Of course, we do not suggest that Section 482 of I.R.C. 1954 was so intended; but that is how the Tax Court and the Court of Appeals have here applied it.

This violation of due process is emphasized by the "business" which, as shown in Reason 1 above, the court below conjured up as a separate entity in order to show control of petitioner by the Cohens. Who owned that other entity? Was it perhaps the petitioner and Fairmount? The court below does not say. This attempt to impose a tax on petitioner here, because of control by the Cohens of some other entity, is in effect to tax petitioner on the income thereby allocated to that other entity, again in the teeth of the *Hoeper* case.

The principle so announced in the *Hoeper* case, that one person cannot be taxed on the income of another, is clearly applicable here. The decision below is palpably in conflict with the rule in that case.

4. This case also important because the interpretation of Section 482 below would make that section invalid due to vagueness, and therefore presents an important issue of general statutory construction.

This Court stated, in *Ashton v. Kentucky,* 384 U.S. 195, 200 (1966): "Vague laws in any area suffer a constitutional infirmity." This applies to any law lacking in objective standards with the result that the law's administrator is given unlimited discretion. *Louisiana v. United States,* 380 U.S. 145, 150, 152-3 (1965).

Under the Treasury regulation applied here by the court below in defining the term "control," as used in Section 482, that term includes, as quoted here by that court from the said regulation, "any kind of control . . ., whether legally enforceable, and however exercisable or exercised." (App. 9.) This is solely the regulation. There is nothing in the statute itself to give the term "control" that scope. And it is that scope, at least, which the court below has applied. To the extent to which the regulation enlarges upon the statute, the regulation is necessarily void. *Manhattan General Equipment Co. v. Commissioner,* 297 U.S. 129, 134; *United States v. Ogilvie Hardware Co., Inc.,* 155 F. 2d 577, 580 (C.A. 5), affirmed 330 U.S. 709, 1 Mertens §3.21, at fns. 81, 82.

Assuming, however, that that is what the statute means, it is so vague that no interpretation can save it.

Here, as already observed in Reason 1 above, the court below attempts to show the Cohens' control of Charles Town by the "course of events which led to the creation of Charles Town," (App. 10) as though control is the series of preceding events, rather than what it is, a presently existing power. If, indeed, that is what the term "control," as used here, can mean, there are no boundaries at all to its meaning. If that is what the statute means, then the statute itself is void. *Ashton v. Kentucky, supra*; *Louisiana v. U.S., supra.*

We submit for that reason that this case is of great importance, not only in the administration of the revenue, but in every other field in which statutory construction is involved.

Conclusion.

Therefore, for the reasons stated above, petitioner prays that this Court issue the writ of certiorari sought herein to the United States Court of Appeals for the Fourth Circuit.

Respectfully submitted,

GEORGE T. ALTMAN,
Attorney for Petitioner.

APPENDIX.

Opinion of the Court of Appeals for the Fourth Circuit.

United States Court of Appeals, for the Fourth Circuit.

Charles Town, Incorporated, Petitioner, versus Commissioner of Internal Revenue, Respondent. No. 10,645.

On Petition to Review the Decision of the Tax Court of the United States.
(Argued December 6, 1966. Decided January 31, 1967.)*

Before Haynsworth, Chief Judge, and Bryan and Craven, Circuit Judges.

George T. Altman (Stanley H. Wilen on brief) for Petitioner, and Albert J. Beveridge, III, Attorney, Department of Justice, (Richard C. Pugh, Acting Assistant Attorney General, Lee A. Jackson and Gilbert E. Andrews, Attorneys, Department of Justice, on brief) for Respondent.

Craven, Circuit Judge:

The Tax Court sustained the action of the Commissioner of Internal Revenue in redistributing income for fiscal years ending November 30, 1958, and 1959, from Fairmount Steel Corporation to Charles Town, Incorporated, under Sections 61 and 482 of the Internal Revenue Code of 1954.[1] The Commissioner's alloca-

*Reported at 372 F. 2d 415.

[1]The Commissioner's "Explanation of Adjustments" which accompanied his notice to Charles Town of the determination of a tax deficiency for the years in question stated that the

(This footnote is continued on the next page)

tion under Section 482 is predicated on the alleged shifting of profits from one controlled entity (Charles Town) to another (Fairmount) for the purpose of utilizing net operating loss carryovers of the latter. Charles Town has petitioned this court under 26 U.S.C.A. Section 7482 to review and reverse the decision of the Tax Court. The facts are related in exhaustive detail in the opinion of the Tax Court.[2]

Fairmount was admittedly controlled at all relevant times by two brothers, Ben and Herman Cohen. Fairmount had allowable net operating loss carryovers from its taxable years ended June 30, 1955, 1956, and 1957, in the amount of $852,105.37.

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income reported by Fairmount "constituted additional income to . . . (Charles Town) under the provisions of Section 61 and Section 482 of the Internal Revenue Code of 1954 . . ."

Section 61 reads in part:

"§ 61. Gross Income defined

"(a) General definition.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but limited to) the following items:

"(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business . . ."

Section 482 reads:

"§482. Allocation of income and deductions among taxpayers.

"In any case of two or more organizations, trades, or business (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses."

[2]The Memorandum Findings of Fact and Opinion of the Tax Court is reported at P-H Tax Ct. Mem. § 66, 015 (January 19, 1966). The findings of fact as reprinted in the petitioner's appendix run to thirty pages.

The Cohens also controlled other business enterprises including Housing Engineering Corporation and C.B. Associates, a partnership which succeeded Housing Engineering upon its liquidation in April 1958. Housing advanced on March 28, 1958 $900,000.00 to Fairmount which ultimately enabled Fairmount to make available a like amount to Charles Town. The advance to Fairmount was not evidenced by any debt instrument, did not bear interest, was made without security, and carried no date for repayment. It was reflected on Housing's books as a debit to "Accounts Receivable" and on Fairmount's books as a credit to "Loans Payable No. 1." The advance eventually was returned in various forms to C.B. Associates with an initial payment being made by Fairmount on March 26, 1959.

Ben Cohen had evinced interest in acquiring the Charles Town Race Course (hereinafter referred to as the Race Course) in Charles Town, West Virginia, since the late 1930's. The opportunity finally came in 1958 when the widow of the former owner, under threat of State franchise revocation, deemed it advisable to carry on serious negotiations.

Ben Cohen was the primary negotiator on behalf of himself and his brother in their individual capacities. Ben Cohen had not determined whether a sale, if consummated, would be to "any particular corporation or individual" and, specifically, did not inform the prospective seller that he was acting in the negotiations for Fairmount.

The Cohens were unable to negotiate a purchase, but a lease of the Race Course was executed May 20, 1958, with *"Ben Cohen, acting for Charles Town, Incorporated,* a corporation to be hereinafter [sic] created . . . as

the Lessee." (Emphasis added.) The initial lease covered the period between May 22 and September 10, 1958.

Concurrently with the execution of the lease on May 20, 1958, an agreement was entered into between Fairmount and Charles Town under which the former agreed to provide the necessary funds for conducting the contemplated racing meet and the latter agreed to operate it for the benefit of former in exchange for ten percent of the net profits. The agreement[3] provided that the directors and officers of Charles Town would be Ben and Herman Cohen and Louis Pondfield, a first cousin and business associate of the Cohens with experience in managing racing events. The agreement also provided that the majority of the officers should make all major decisions in the management of the racing meet "so long as Charles Town shall be indebted to Fairmount. . . ."

A Certificate of Incorporation was formally issued by West Virginia to Charles Town on May 22, 1958. The main object of the corporation was to "engage in and carry on the business of operating a race track . . ." Its principal office was listed as the Baltimore address of the Cohen brothers. One hundred shares of Charles Town stock were issued. Ninety-eight were in the name of Louis Pondfield and one each in the names of Ben and Herman Cohen.

Charles Town assumed its obligations under the lease and the agreement with Fairmount and adopted bylaws providing that its board of directors would control and manage the corporation. Ben Cohen, Her-

[3]The agreement in full is included in the opinion of the Tax Court.

man Cohen, and Louis Pondfield were elected directors and constituted the full board of directors until May 15, 1961. They also served during this time as president, secretary-treasurer, and vice-president respectively.

Following subsequent negotiations conducted by Ben Cohen on behalf of Charles Town, a second lease was executed on November 3, 1958, granting Charles Town use of the Race Course for the period of November 20, 1958, through February 20, 1959. The second lease was similar in all pertinent respects to the original lease. A second identical agreement was entered into with Fairmount providing for the financing of a winter racing meet during the term of the new lease.

In the course of the period with which we are concerned, running until the close of Charles Town's fiscal year on November 30, 1959, Fairmount made payments to and on behalf of Charles Town, pursuant to its two agreements, in the aggregate amount of $986,525.00. These included funds for rent of the Race Course, opening balances in Charles Town's various bank accounts, and the "bankroll" necessary to commence wagering operations. These advances were credited on Charles Town's books to an account styled "Account Payable—Fairmount Steel Corporation," with the exception of $20,000.00 which was credited to an account entitled "Advances from Fairmount Steel Corporation." The advances were debited on Fairmount's books to an account termed simply "Charles Town, Inc."

The income and expenses with respect to the two racing meets were reflected on the books of Charles Town. However, by a journal entry all the income and expenses, with the exception of officer's salaries, were

transferred to the books of Fairmount, and a second journal entry was used to allocate ten percent of the net profits to Charles Town. The entries were made on June 30, 1958, covering transactions to that date, which was the end of Fairmount's fiscal year; in November 1938, covering the remainder of the first racing meet; and in the spring of 1959, covering the second racing meet.

Fairmount reported on its federal income tax returns the gross receipts and all the expenses in connection with the operation of the two racing meets and claimed a deduction for commission expense representing the ten percent of the net profits allocated to Charles Town. Fairmount's return for its fiscal year ended June 30, 1959, showed a net profit of $732,299.86 from the racing meets, but because of its allowable net operating loss carryover, it paid no federal income tax on this amount.

On its federal tax returns for the periods in question Charles Town reported gross receipts representing ten percent of the net profits from the racing meets. Charles Town claimed deductions for the compensation paid its officers and for small contributions to the Herman and Ben Cohen Charitable Foundation.

Although Charles Town now contends it was engaged in a joint venture with Fairmount, no partnership returns were filed with the Internal Revenue Service reflecting any of the income or expenses from either of the racing meets.

Charles Town *Properties,* which had been incorporated on April 19, 1958, consummated a contract for the purchase of the Race Course on May 7, 1959. Ninety percent of the stock in Charles Town Properties was

acquired by the Cohen interests and since May 19, 1959, the Cohen brothers have constituted its principal officers and a majority of its board of directors.

Fairmount was liquidated on June 1, 1962. Charles Town, Incorporated, has been dormant since the spring of 1959—having conducted no business other than the two racing meets under consideration here.

The Commissioner, acting pursuant to Sections 61 and 482 of the Internal Revenue Code, allocated additional income to Charles Town of $732,299.86, representing the ninety percent of the profits from the racing meets which had been reported by Fairmount. A deficiency, as a result, was assessed against Charles Town for the fiscal year ended November 30, 1958, of $258,616.93 and for the year ended November 30, 1959, of $117,367.57.

The Tax Court, in sustaining the Commissioner, found as ultimate facts that Charles Town was organized for the purpose of conducting the two racing meets *in its own right;* that it performed substantial income-producing activities; and that it produced or earned the total net income from the racing meets. In addition, the Tax Court found that the Commissioner, in allocating the income reported by Faimount to Charles Town, did not act unreasonably, arbitrarily, or capriciously, and that the allocation was necessary in order to prevent the evasion of taxes and to clearly reflect the taxable income of Charles Town within the meaning of Section 482 of the Internal Revenue Code. The tax Court concluded that "no serious question can arise as to control of both Fairmount and Charles Town by the Cohen brothers" as *control* is used in Section 482. It also found that the advances to Charles Town by Fairmount were in substance equity investments.

Section 482 of the Internal Revenue Code authorizes in any case where two businesses are controlled *directly* or *indirectly* by the same interest an allocation of gross income and deductions between them if it is determined that this is necessary to prevent tax evasion or clearly to reflect the income of either business. The purpose of this provision "is to place a controlled taxpayer on a tax parity and an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true taxable income from the property and business of a controlled taxpayer." Treas. Reg § 1.482-1(b); see, *e.g., Aiken Drive-In Theatre Corp. v. United States,* 281 F.2d 7, 9-10 (4th Cir. 1960). The legislative history of Section 482 indicates it was "designed to prevent the avoidance of tax or the distortion of income by the shifting of profits from one business to another." *Rooney v. United States,* 305 F.2d 681, 683 (9th Cir. 1962).[4]

Charles Town contends that there was not on the present facts sufficient control of both it and Fair-

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[4]Section 1.482-1(c) of the Treasury Regulations under the Internal Revenue Code of 1954 provides:

> "Transactions between one controlled taxpayer and another will be subjected to special scrutiny to ascertain whether the common control is being used to reduce, avoid, or escape taxes. In determining the true taxable income of a controlled taxpayer, the district director is not restricted to the case of improper accounting, to the case of a fraudulent, colorable, or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income, deductions, credits, or allowances. The authority to determine true taxable income extends to any case in which either by inadvertence or design the taxable income, in whole or in part, of a controlled taxpayer, is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer."

mount by the "same interests" to justify the Commissioner's application of Section 482. Charles Town's position is that "section 482 applied only to transactions between *already* controlled taxpayers" and that control by the Cohens of Charles Town was affected by and wholly dependent on the intercorporate agreements of May 20 and November 3, 1958, which are themselves the transactions which governed the original distribution of income challenged by the Commissioner. It is true that common "control or ownership must exist when the taxpayers deal with each other." *Rooney v. United States,* 305 F.2d 681, 683 (9th Cir. 1962).

The question of control is one of fact which was determined adversely to Charles Town by the Commissioner and in the Tax Court. The Tax Court's finding may not be reversed unless it is "clearly erroneous." See Int. Rev. Code of 1954, § 7482, *Commissioner v. Duberstein,* 363 U.S. 278, 291 (1960); *Hall v. Commissioner,* 294 F.2d 82, 85 (5th Cir. 1951). By the very terms of Section 482 control can be either *direct* or *indirect.* The regulations promulgated under Section 482 define control to include "any kind of control . . . whether legally enforceable, and however exercisable or exercised. It is the reality of control which is decisive, not its form or the mode of its exercise." Treas. Reg. § 1.482-1 (a) (3).

We cannot say that the Tax Court was clearly in error when it determined there was sufficient control of Charles Town and Fairmount by the same interests (the Cohens) to permit the Commissioner's application of Section 482. We agree with the Tax Court that the control exercised by the Cohens by reason of the intercorporate agreements between Charles Town and Fair-

mount "was only one of several facts . . . by which their actual and effective control of the corporation was acquired and exercised."

The Cohens, of course, retained control of Charles Town until May 1961 by reason of their election to positions as directors and officers which occurred upon organization of the corporation. However, they also controlled the negotiations and entire course of events which led to the creation of Charles Town, the acquisition of the lease for the Race Course, and the execution of the agreement between Fairmount and Charles Town assuring essential capital for the new corporation and their *continued* control of the business venture. The Cohens caused the actual incorporation of Charles Town, as shown vividly by the incorporating attorney's testimony that it was the Cohens "at . . . whose request . . . [he] set up this corporation." The documents relating to the incorporation were, in fact, forwarded to the offices of the Cohens in Baltimore where Charles Town's books and records were maintained.

Notwithstanding the ownership by Louis Pondfield of ninety-eight percent of the outstanding shares of Charles Town upon incorporation, the Tax Court was justified in concluding that the Cohen brothers were at all times in effective "control" of the *business* known as Charles Town, Incorporated. Pondfield gave up the control he could have exercised as majority stockholder when he permitted Charles Town to contract that the Cohen brothers could not be removed from majority control of the Charles Town Board of Directors until the money advanced by Fairmount was returned. This was "the reality of control."

The Tax Court concluded, after making a thorough examination of the relationship between Charles Town and Fairmount and relying on *National Carbide Corp. v. Commissioner,* 336 U.S. 422 (1949), that though in form the intercorporate agreements here purport to constitute Charles Town an agent of Fairmount for conducting the racing meets in question, no agency for tax purposes was established. Counsel for Charles Town now agrees that an agency relationship was not created,[5] but continues to maintain that the racing meets were conducted as a joint venture to which Fairmount contributed capital and Charles Town undertook management with the income to be divided as provided in the intercorporate agreements. The Tax Court found, however, that there was in fact no joint venture but that "Charles Town earned the income in question."

The determination of whether the income was earned by Fairmount and Charles Town participating in a joint venture or by Charles Town itself "is, at least, primarily, the determination of a question of fact, and, in order for this court to reverse the finding of the Tax Court, it must be shown that the finding is clearly erroneous." *Ballentine Motor Co. v. Commissioner,* 321 F.2d 796, 798 (4th Cir. 1963). After carefully reviewing the record, we believe the Tax Court was justified in finding that the racing meets were conducted and the income from them earned by Charles Town in its own right.[6]

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[5]The concession was twice made in oral argument before this court.

[6]As was noted above, the Tax Court found that the advances to Charles Town were in substance contributions to capital by Fairmount. Thus, the payment of ninety percent of the net income from the racing meets to Faimount would to the extent it exceeded Fairmount's advances be characterized as

(This footnote is continued on the next page)

Charles Town was itself the party to the lease of the Race Course which was the source of the income, and in fact sued the lessor in its own name for an alleged overpayment of rent. Charles Town obtained in its name the licenses to conduct the meets from the West Virginia Racing Commission, and represented in supporting statements that it was the applicant, that the Race Course was to be conducted by the corporation under the name of Charles Town, Incorporated, and that Fairmount had "advanced by loan, or otherwise, the capital invested in the business." Charles Town maintained four separate bank accounts in its name and its own books of account which reflected all transactions in respect to the meets. Charles Town itself hired the substantial number of employees necessary to operate the Race Course, and paid to them more than $630,000.00 in wages over the period of the two racing meets.[7]

Charles Town also entered into in its own name numerous contracts for materials and services rquired to conduct the racing meets. Charles Town acquired membership in and paid assessments to the Thoroughbred Racing Association of the United States whose bylaws provide that members shall consist of thoroughbred racing associations duly organized and conducting business. Charles Town elected to participate in the West Virginia Workmen's Compensation Plan and filed various state and federal tax information forms.

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dividends, and would be subject, presumably, to the intercorporate dividend deduction provided in Int. Rev. Code of 1954, § 243. It has never been contended by Charles Town that the advances by Fairmount were intended as loans.

[7]In its initial statement for the West Virginia Department of Employment Security, Charles Town indicated employment of over three hundred and fifty employees during a typical week for its reported business of "Thoroughbred Horse Racing."

Thus, the facts may be viewed as supporting the conclusion of the Tax Court that the "business purpose of Charles Town was the operation of the track in its own right" and that it did "all things necessary to earn the income in question" by operating the two racing meets.

The present position of Charles Town that it was a party to a joint venture with Fairmount in which Fairmount contributed the capital and Charles Town the management services does not find convincing support in the record. The reasoning of the Tax Court on this question is persuasive. The Tax Court noted

> "that is not the way the contract between them was drawn. The agreement was that Charles Town was to operate the race track 'for the benefit of Fairmount' except that 'Charles Town shall receive 10 per cent (10%) of the profits for its services.' This is not the language of a joint venture. The parties did not hold themselves out to the public as joint venturers. . . . The fact that the parties treated the income returned by Charles Town as 'commissions' is further indicative that the parties were not joint venturers. Under West Virginia, case law, a joint venture is considered to be a limited partner. *Horchler v. Van Zandt*, 120 W. Va. 452, 199 S.E. 65 (S. Ct. App. 1938). No partnership returns were filed. The only returns that were filed were those of Fairmount and Charles Town as separate corporations."

In addition, it was important for the Cohens and Fairmount to have the racing meets conducted by a corporate entity as opposed to having Fairmount enter into a joint venture in order to limit Fairmount's liabil-

ity to the advances actually made to Charles Town. The Tax Court specifically found that "one of the purposes of forming Charles Town was to limit liability for possible claims for personal injuries and other liability that could arise out of the operation of the meet." When the lease was executed for the Race Course "over 100 improvements were required by the insurance company as a condition of writing the policy . . . Despite such improvements there was still danger of claims in excess of the insurance coverage."

Charles Town contends that the clauses in the inter-corporate agreements with Fairmount providing that "if the result of the operation shall result in a loss, such loss shall be borne by Fairmount . . ." and that "any loss shall be borne entirely by Fairmount" obviates in any case the ordinary protective attribute afforded by the corporate form. We do not agree with Fairmount's interpretation of these clauses. We believe they were inserted to prevent Fairmount from charging back any of its capital losses against Charles Town and would not extend Fairmount's financial responsibility beyond the agreed advances for failures by Charles Town or liability for its torts. Here the Cohens selected the corporate form for the operation of the racing meets. One "is free to adopt such organization for his affairs as he may choose and having elected to do . . . business as a corporation, he must accept the tax disadvantages." *Higgins v. Smith*, 308 U.S. 483, 477 (1940).

Finally, Charles Town objects to the allocation to it of the *entire* net income from the racing meets on the basis that the "allocation of all the fruits to Charles Town alone is directly contrary to the requirement" in Section 482 that "the Secretary or his delegate may

distribute, apportion, or allocate . . . between or among . . ." the controlled businesses. This contention is without merit. The Commissioner has broad discretion in making such allocations and they will not be countermanded unless the taxpayer shows them to be unreasonable, arbitrary, or capricious. *E.g., Spicer Theatre Inc.* v. *Commissioner,* 346 F.2d 704, 706 (6th Cir. 1965); *Balentine Motor Co. v. Commissioner,* 321 F.2d 796, 800 (4th Cir. 1963); *Aiken Drive-In Theatre Corp. v. United States,* 281 F.2d 7, 10 (4th Cir. 1960); *Dillard-Waltermire, Inc. v. Campbell,* 255 F.2d 433, 435-36 (5th Cir. 1958). Moreover, this circuit recently has held specifically that the Commissioner may transfer the total income and expenses of one controlled corporation to another under Section 482. *J. R. Land Co. v. United States,* 361 F.2d 607 (4th Cir. 1966).

In view of our conclusion that the Tax Court was not clearly erroneous in finding that Charles Town itself earned the income from the two racing meets, the Commissioner's allocation of the *total* net income to Charles Town plainly is not unreasonable or arbitrary. Anticipatory agreements designed to prevent the vesting of income in the owners, which was determined to be the essential nature of the intercorporate agreements in the instant case, will be disregarded and the tax assessed against the entity earning the income. *National Carbide Corp. v. Commissioner,* 336 U.S. 422 (1949); *Commissioner v. Sunnen,* 333 U.S. 591 (1948); *Helvering v. Eubank,* 311 U.S. 122 (1940); *Lucas v. Earl,* 281 U.S. 111 (1930).

The decision of the Tax Court is affirmed.

Affirmed.

Order Denying Petition for Rehearing.

United States Court of Appeals for the Fourth Circuit.

Charles Town, Incorporated, Petitioner, versus Commissioner of Internal Revenue, Respondent. No. 10,645.

After consultation with all the members of the court, the petition for rehearing en banc or, alternatively, before the panel is denied.

This 23rd day of March, 1967.

Clement F. Haynsworth Jr.
Chief Judge, Fourth Circuit

Albert V. Bryan
United States Circuit Judge

J. Braxton Craven, Jr.
United States Circuit Judge

A true copy,
Teste:

Maurice S. Dean, Clerk,
U.S. Court of Appeals for the Fourth Circuit

[Seal]

Findings and Opinion of the Tax Court.

T. C. Memo. 1966-15

Tax Court of the United States

Charles Town, Incorporated, Petitioner v, Commissioner of Internal Revenue, Respondent. Docket No. 3517-62.

Filed January 19, 1966.

Held, the income derived from the operation of two horse racing meets was earned by petitioner, and petitioner is subject to Federal income taxes on such income.

George T. Altman and *Stanley H. Wilen,* for the petitioner.

Stuart E. Seigel and *Dennis R. Powell,* for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION.

ARUNDELL, *Judge:* Respondent determined deficiencies in petitioner's income tax for the period May 22, 1958, to November 30, 1958, of $258,616.93, and for the fiscal year ending November 30, 1959, of $117,367.57.

Petitioner assigned error as follows:

(a) The Commissioner erred by including the income of Fairmount Steel Corporation in the income of the petitioner in the following amounts:

Fiscal Year Ended	Gross Income Erroneously Included	Taxable Income Erroneously Included
November 30, 1958	$2,808,220.18	$497,833.02
November 30, 1959	2,056,444.34	234,466.84

FINDINGS OF FACT

Some facts are stipulated and are found accordingly.

Charles Town, Incorporated, hereinafter sometimes referred to as Charles Town, is a corporation incorporated on May 22, 1958, under the laws of the State of West Virginia.

Charles Town filed Federal corporation income tax returns for the period May 22, 1958, to November 30, 1958, and for the fiscal year ended November 30, 1959, with the district director of internal revenue, Baltimore, Md.

Fairmount Steel Corporation, hereinafter sometimes referred to as Fairmount, was incorporated on July 5, 1951, under the laws of the Commonwealth of Pennsylvania.

The issued and outstanding stock of Fairmount, at all times material hereto, consisted of Class A common stock, which had the exclusive voting rights, and Class B common stock. The Class A common stock was issued for $1 per share as follows:

Ben Cohen	50 shares
Herman Cohen	50 shares

At all times material hereto, Ben Cohen and Herman Cohen have held all the issued and outstanding Class A common stock of Fairmount. The Class B common stock was issued for $50 per share as follows:

Ben Cohen (younger brother of Herman)	175 shares
Herman Cohen (older brother of Ben)	175 shares

Herman Cohen, Ben Cohen, and Stanley H. Wilen, Trustees for Charlotte Cohen (daughter of Ben) now Charlotte Weinberg ..... 100 shares

Rosalee Cohen (daughter of Ben) .... 100 shares

Jacob Kartman, Ben Cohen, and Rosa L. Cohen (wife of Hernan), Trustees for Nathan L. Cohen (son of Herman) .....200 shares

Raymond Voyes .....250 shares

In March 1953 the shares of stock originally issued to Raymond Voyes were transferred to a partnership consisting of Herman Cohen and Ben Cohen. In 1957 the shares of stock originally issued to the aforementioned trustees for Charlotte Cohen were distributed by said trustees to Charlotte Cohen, individually. There were no other changes in the ownership of the Class B common stock at any time material hereto, and the foregoing represented all the issued and outstanding Class B common stock.

The officers of Fairmount, from its inception and at all times material hereto, all of whom constituted its board of directors, were as follows:

President	Herman Cohen
Vice President and Secretary-Treasurer	Ben Cohen
Assistant Secretary-Treasurer	Rosa L. Cohen
Assistant Secretary-Treasurer	Zelda G. Cohen (wife of Ben)

In addition, in 1954 and at all times material thereafter, Richard Davison (husband of Rosalee) became an assistant secretary of Fairmount, although he did not serve as a director.

Housing Engineering Corporation, hereinafter sometimes referred to as Housing, was incorporated under the laws of the State of Maryland, on June 25, 1952. Its issued and outstanding capital stock, all of which was common stock, was held at all times during its existence as follows:

Name	No. of Shares
Ben Cohen	100
Herman Cohen	100
Zelda G. Cohen	100
Rosa L. Cohen	100
Herman Cohen, Zelda G. Cohen, and Jacob Kartman, Trustees for Charlotte Cohen now Charlotte Weinberg	100
Herman Cohen, Zelda G. Cohen, and Jacob Kartman, Trustees for Rosalee Cohen, now Rosalee Davison	100
Ben Cohen, Rosa L. Cohen, and Jacob Kartman, Trustees for Nathan L. Cohen	200

At all times during its existence, the following were the officers and also constituted the board of directors of Housing:

President	Ben Cohen
Vice President	Herman Cohen
Treasurer	Ben Cohen
Secretary	Herman Cohen
Assistant Treasurer	Rosa L. Cohan
Assistant Secretary	Richard Davison
Assistant Secretary-Treasurer	Zelda G. Cohen

Housing was liquidated on April 29, 1958, and was succeeded by a partnership known as C. B. Associates, composed of the same persons who were the stockholders of Housing, retaining the same percentage interest in the partnership as they had held in the corporation.

In December 1952 Herman and Ben Cohen acquired controlling interest in the Maryland Jockey Club of Baltimore City, Inc., hereinafter sometimes referred to as the Maryland Jockey Club. At or about the same time Louis Pondfield (a first cousin of Herman and Ben) acquired an interest in the Maryland Jockey Club which eventually amounted to 7½ percent. Since that time the Maryland Jockey Club has owned and operated the Pimlico Race Course, Baltimore, Md.

Ben Cohen had at various times dating back to the 1930's been interested in acquiring the Charles Town Race Course in Charles Town, W. Va., hereinafter sometimes referred to as the Race Course. In his discussions and negotiations in that connection Ben Cohen was always accompanied by Pondfield who brought this opportunity to his attention.

Albert Boyle, the owner of the Charles Town Race Course, died in November 1957. Some time thereafter Ben and Herman Cohen, hereinafter sometimes referred to collectively as the Cohen brothers, accompanied by Pondfield, had negotiations, with regard to purchasing the Race Course, with Harry Byrer, an attorney who represented Boyle's widow, Helene W. Boyle, hereinafter sometimes referred to as Helene Boyle, and the Estate of Albert Boyle, deceased. Ben Cohen was the primary negotiator on behalf of the Cohen brothers during these negotiations.

Ben Cohen carried on these negotiations on behalf of himself and Herman Cohen in their individual capacities and had not determined whether the purchase, if consummated, would be effected in their individual capacities, by some existing corporation, or by a corporation to be organized for that purpose. He intended to make the decision after the deal was concluded. He never advised Byrer that he was acting on behalf of Fairmount.

By letter dated February 3, 1958, from Byrer to "Messrs. Cohen Bros.," an offer was made to sell the Race Course upon specified terms and conditions. The proposal provided, in part, that the property would not be assignable to any person or corporation without the written consent of Helene Boyle except that a West Virginia corporation could be formed to which the property could be transferred. However, such a corporation was to be prohibited from assigning or transferring the property without Helene Boyle's written consent.

By letter dated February 5, 1958, from Ben Cohen to Byrer, a counteroffer was made in accordance with the terms of an offer made in the previous year.

By memorandum dated March 24, 1958, Herman Cohen advised Ben Cohen that further proposals which he and Pondfield had discussed that day with Byrer were under consideration.

On March 28, 1958, Housing paid $900,000 to Fairmount. Said payment was reflected on Fairmount's books as follows: A debit to cash in the amount of $900,000 and a credit to an account entitled "Loans Payable # 1," entry dated April 3, 1958. Said payment was reflected on Housing's books as a credit to

cash and as a debit to an account entitled "Accounts Receivable."

This payment was not evidenced by any notes or other debt instrument, did not bear interest, was made without security, and no date for repayment was specified.

At the time these funds were advanced to Fairmount, Fairmount was insolvent.

By letter dated March 31, 1958, from Byrer addressed to "Messrs. Cohn Bros.," the proposals referred to by Herman Cohen in the memorandum of March 24, 1958, were rejected.

Subsequently, about the middle of May 1958, the West Virginia Racing Commission issued an ultimatum to Helene Boyle that if a summer meet of that race track was not operated, they would take her franchise away. This led to the immediate negotiations between Ben Cohen and Byrer relative to the leasing of the track by Helene Boyle to a West Virginia corporation to be formed, known as Charles Town, Incorporated.

On May 20, 1958, a lease was executed, the first paragraph of which read as follows:

> THIS LEASE made and executed this 20th day of May, 1958, by and between Helene W. Boyle * * * as the Lessor, and *Ben Cohen, acting for Charles Town Incorporated, a corporation to be hereinafter created* under the laws of the State of West Virginia, hereinafter designated and referred to as the Lessee. [Emphasis supplied.]

The Cohen brothers requested Clarence E. Martin, Jr., an attorney in Martinsburg, W. Va., to cause Charles

Town to be created. Martin prepared the application for charter which was executed on May 17, 1958.

Charles Town was duly incorporated under the laws of the State of West Virginia on May 22, 1958. Its certificate of incorporation provided, in part, that the principal office of the corporation would be located at 1229 Mt. Royal Avenue, Baltimore, Md., which address was the office of the Cohen brothers. The objects for which the corporation was formed were to engage in and carry on the business of operating a race track. The corporation's authorized capital stock was 1,000 shares of common stock of a par value of $10 each. However, only 100 shares were issued by certificates dated May 22, 1958, as follows:

Certificate No.	Issued to	No. of Shares
1	Herman Cohen	1
2	Ben Cohen	1
3	Louis Pondfield	98

The said stock was issued for the total sum of $1,000 which was not paid until July 22, 1958. During taxable periods here involved, no additional stock was issued to any person and the aforementioned 100 shares represented all of the issued and outstanding stock during said periods of time.

The previously mentioned lease executed on May 20, 1958, between Helen Boyle and Ben Cohen, acting for Charles Town, provided in part as follows:

> This lease shall begin on the 22nd day of May, 1958, and unless sooner terminated as herein provided shall continue to and include the 10th day of September, 1958.

As rental for said premises for the full term of this lease, said Lessee shall pay to the Lessor the sum of Two Hundred and Twenty Five Thousand Dollars.

* * * * *

The Lessee shall be entitled to all income from the operation of the horse racing meets to be conducted on said premises and from any and all other commercial operations conducted thereon * * *. * * * and the Lessee assumes all risks to persons or property from latent or patent defects in the premises and fixtures thereon; the Lessor shall not be liable to the Lessee or any other person for any loss or claim of any kind whatsoever resulting from the operation of the aforesaid premises and the use thereof by the Lessee; that the Lessee shall immediately, upon execution of this instrument secure and keep in force and effect during the continuance of this lease, proper and effective comprehensive liability insurance in the sum of $500,000.00, issued by a reputable solvent insurance company qualified and authorized to do business in the State of West Virginia.

* * * * *

It is expressly understood and agreed between the parties hereto, that this lease is entered into, upon the express condition that the Lessee or his assignee aforesaid, shall be able to secure from, and be granted, a license by, the West Virginia Racing Commission, permitting him or his said assignee to conduct a horse race meeting on the aforesaid premises for at least 56 days during the leasehold period aforesaid, and in the event

such license shall not be granted or secured as aforesaid, then this lease shall be forthwith null and void and of no effect and thereupon all rights and obligations of the parties hereto will be at an end, except that the Lessor shall forthwith return to the Lessee the consideration paid to the Lessor by the Lessee as aforesaid; the Lessee agrees, however, to make prompt and diligent application for such license and use every available effort to secure the same, subject to the check for $225,000.00 being good.

By check dated May 20, 1958, Fairmount paid the sum of $225,000 to Helene Boyle, which payment was reflected on Fairmount's books at a debt to an account entitled "Charles Town, Inc." and a credit to cash.

A supplemental agreement dated May 22, 1958, was executed between Helene Boyle and Ben Cohen, acting for Charles Town whereby an additional rental of $25,000 was agreed upon in view of the fact that the West Virginia Racing Commission authorized racing dates at the Race Course for a period in excess of that originally contemplated by the parties. The additional $25,000 was to be paid "$15,000.00 upon the execution of this agreement and $10,000.00" on September 2, 1958.

By check dated May 22, 1958, Fairmount paid the sum of $15,000 to Helene Boyle, which payment was reflected on Fairmount's books as a debit to an account entitled "Charles Town, Inc." and a credit to cash.

Fairmount also paid to or on behalf of Charles Town the following amounts on the dates indicated, which amounts were all reflected on Fairmount's books as

debits to the account on "Charles Town, Inc." and credits to cash:

May 26, 1958	$ 5,000
May 26, 1958	5,000
May 28, 1958	2,025*
May 28, 1958	1,000
May 28, 1958	1,000
May 28, 1958	225,000
Nov. 5, 1958	224,250**
Nov. 5, 1958	63,250***
Dec. 5, 1958	200,000
Nov. 24, 1959	20,000

*Reimbursed by Charles Town to Fairmount on June 10, 1958.

**Payable to the Citizens National Bank of Martinsburg, West Virginia.

***Payable to Helene Boyle.

The foregoing advances made by Fairmount to Charles Town in the total amount of $986,525 were reflected on Charles Town's books as credits to an account entitled "Account Payable—Fairmount Steel Corp." with the exception of the payment of $20,000, which was credited to a ledger account entitled "Advances from Fairmount Steel Corp."

The advances from Fairmount to Charles Town were not evidenced by any notes or other debt instruments, did not bear interest, were made without security, and no date for repayment was specified. They were not intended as loans.

The said advances were made pursuant to and in accordance with the agreement hereinafter mentioned, dated May 20, 1958, between Fairmount and Charles

Town for the purpose of furnishing the capital necessary to run the racing meets and were used to make rental payments to Helene Boyle, for deposits of opening balances in various bank accounts, and for "bankroll," which are the funds necessary to be on hand to commence wagering operations.

The officers of Charles Town, from its inception until May 15, 1961, all of whom constituted its board of directors, were as follows:

President	Ben Cohen
Vice President	Louis Pondfield
Secretary-Treasurer	Herman Cohen

The bylaws of Charles Town provided that the board of directors shall have the control and management of the affairs, business, and properties of the corporation.

Because of the poor condition of the grandstand and other hazardous conditions when the May 20, 1958, lease was executed, over 100 improvements were required by the insurance company as a condition of writing the policy; and the said improvements were made. Despite such improvements there was still danger of claims in excess of the insurance coverage.

One of the purposes of forming Charles Town was to limit liability for possible claims for personal injuries and other liability that could arise out of the operation of the meet. Its chief purpose, however, was to operate a race track.

On May 20, 1958, concurrently with the execution of the lease of that date, an agreement was entered into between Fairmount and Charles Town under which Fairmount agreed to provide the funds necessary for conducting said meet and Charles Town agreed to operate

said meet for the benefit of Fairmount. The agreement provided as follows:

THIS AGREEMENT, Made and entered into this 20th day of May, 1958 by and between FAIRMOUNT STEEL CORPORATION, a Pennsylvania corporation (hereinafter referred to as "Fairmount") and CHARLES TOWN INCORPORATED, a corporation created under the laws of West Virginia (hereinafter referred to as "Charles Town").

STATEMENT OF FACTS

Fairmount, through its officers, has for sometime been negotiating with the attorneys representing Helene W. Boyle, in her own right and as Executrix of the Estate of Albert J. Boyle, deceased, for the purchase of the Charles Town Turf Club in Charles Town, Jefferson County, West Virginia, and

Whereas, Charles Town has leased the said Charles Town race track for the purpose of operating a racing meet for such number of days as the West Virginia Racing Commission will grant a license to conduct a horse racing meet on the premises, and

Whereas, Charles Town does not have the funds, nor the credit, with which to operate the said racing meet, and

Whereas, Charles Town has negotiated with Fairmount for the purpose of obtaining the necessary funds for the financing of the said racing meet and

Whereas, Fairmount has agreed to advance to Charles Town a minimum of Four Hundred Fifty Thousand Dollars ($450,000.00) for the financing of the racing meet, including the sum of Two Hundred Twenty-Five Thousand Dollars ($225,000.00) which Fairmount has already advanced for the payment of the rent due pursuant to the said lease, provided that Charles Town agree to operate the said race meet for the benefit of Fairmount and shall receive for this operation ten per cent (10%) of the net profits for its services thereunder, and if the result of the operation shall result in a loss, such loss shall be borne by Fairmount, and

Whereas, it was understood that the operations of said race meeting shall be conducted pursuant to the terms of this Agreement.

Now Therefore This Agreement Witnesseth that in consideration of the mutual covenants and conditions herein contained and other good and valuable considerations, the parties agree as follows:

1. Charles Town shall apply for a licence to conduct a racing meet at the Charles Town Race Track in Charles Town, Jefferson County, West Virginia for as many days as said club shall be permitted to operate, said meeting to be conducted between the days of May 23, 1958 and September 10, 1958.

2. The said race meeting shall be operated by Charles Town, but the profits therefrom shall be for the benefit of Fairmount except that Charles Town shall receive ten per cent (10%) of the profits for its services in the operation of the said

racing meet and any loss shall be borne entirely by Fairmount.

3. In consideration of Fairmount receiving ninety per cent (90%) of the profits of the said meet, Fairmount agrees to advance all monies necessary for the operation of the said meet, it being understood that Fairmount will advance a minimum of Four Hundred Fifty Thousand Dollars ($450,000.00) to finance said costs of operations of said meet.

4. No interest will be charged by Fairmount for the use of its monies, it being understood that its share of the profits shall be in lieu of all interest charges of any kind.

5. Charles Town shall pay all officers for their services on behalf of both corporations, out of its share of the profits of the meet and no part thereof shall be charged to Fairmount.

6. Full and complete records of all receipts and disbursements in connection with the said meet shall be maintained by Charles Town and no expenditures, out of the ordinary course of business shall be made without the approval of Fairmount. Charles Town shall, at the request of Fairmount, make a complete accounting of all such receipts and disbursements.

7. So long as Charles Town shall be indebted to Fairmount, the officers and directors of Charles Town shall be as follows:

President and Director	Ben Cohen
Vice President and Director	Louis Pondfield
Secretary, Treasurer and Director	Herman Cohen

8. The majority of the above officers shall make all major decisions as to the allocation of income and expenses and in the management of the race meet.

9. Federal and State taxes on income of the respective parties shall be a separate obligation to be borne by each party as to its own income.

10. Charles Town shall carry all necessary insurance to protect itself as well as Fairmount from all hazards. The cost of said insurance shall be regarded as an expense of operation of the said racing meet.

In Witness Whereof, the parties have caused this Agreement to be executed the day and year first above written.

This agreement was executed on behalf of Fairmount by Herman Cohen as its president, and on behalf of Charles Town by Pondfield as its vice president.

At this time, Fairmount had allowable net operating loss carryovers from its taxable years ended June 30, 1955, June 30, 1956, and June 30, 1957, in the total amount of $852,105.37.

The minutes of the organization meeting of the stockholders of Charles Town, dated May 22, 1958, state in part as follows:

Thereupon, discussion was had relative to the lease contract between Ben Cohen, agent, and Helene W. Boyle concerning the lease by him on behalf of this corporation * * *, said lease agreement being laid before the meeting.

Upon motion duly made and seconded it was unanimously,

Resolved that the lease agreement between Helene W. Boyle and Ben Cohen, agent, acting on behalf of this corporation, dated the 29th day of May, 1958, and the supplemental agreement affixed thereto, dated the 22nd day of May, 1958, be and the same are, in every respect, hereby accepted, ratified confirmed and approved by this corporation, all acts of the said Ben Cohen, acting as aforesaid, be and the same are hereby ratified, confirmed and approved by this corporation, without recourse upon the said Ben Cohen.

Thereupon, a discussion was had relative to the financing of the racing meeting provided for under the lease agreement aforesaid.

Upon motion duly made and seconded, it was unanimously

Resolved that the Directors and Officers of this corporation, enter into and execute such loans, agreements and obligations on behalf of this corporation, as necessary in order to provide for and conduct a horse race meeting on the properties leased by this corporation as aforesaid.

Thereupon a proposed contract between this corporation and Fairmount Steel Corporation, having been read to the meeting, discussion was had upon the same, and thereupon on motion duly made and seconded, it was unanimously

Resolved that this corporation enter into such contract with Fairmount Steel Corporation, that the appropriate officers of this corporation, when elected, execute the same on behalf of this corporation, and a copy thereof be placed in the files of this corporation. * * *

The minutes of a meeting of the board of directors of Charles Town dated May 22, 1958, authorized the Peoples Bank of Charles Town, Charles Town, W. Va., the Bank of Charles Town, Charles Town, W. Va., and the Merchants and Farmers Bank of Martinsburg, W. Va., as depositories of the corporation and resolved that "all funds belonging to the corporation be deposited in said banks."

A press release contained in the files of Charles Town, located at the offices of Cohen Brothers, 1229 Mt. Royal Ave., Baltimore, Md., stated in part:

> Charles Town, W. Va., race track will open a 75-day meeting on Friday, June 6, under new management headed by the present officers of Pimlico Race Course in Baltimore, Maryland, it was announced at noon today.
>
> Assuming operating control of the three-quarter mile track is Charlestown, Inc., headed by Ben Cohen, President, Herman Cohen, Secretary-Treasurer, and Louis Pondfield, Vice-president.
>
> All are native Baltimore businessmen who have operated Pimlico Race Course since 1953.
>
> The new corporation will assume operating control of the Charlestown track immediately under terms of a private agreement with Mrs. Albert J. Boyle, widow of the founder of the West Virginia track who died last November.

On November 3, 1958, a lease hereinafter sometimes referred to as the second lease, was executed between Helene W. Boyle and Charles Town covering a lease of the Race Course for the period November 20, 1958, through February 20, 1959. This lease was in all

material respects similar to the first lease except that the rental provided for was the sum of $63,250 payable on execution of the lease, plus an additional sum of $5,750 per day multiplied by the number of racing days to be allotted by the West Virginia Racing Commission, hereinafter sometimes referred to as the Racing Commission, during the period January 1, 1959, through February 14, 1959. It was further provided, however, that in the event 2 percent of the total amount wagered at the track during the period of the lease should aggregate a sum in excess of the aggregate thereinbefore provided on a daily basis of $5,750 a day for the total number of racing days, Charles Town was to pay such excess at a specified time. The lease also required Charles Town, during the period of the lease, to keep in force and effect comprehensive liability insurance in the sum of $1,000,000. Charles Town was also required to make application to the Racing Commission for a license permitting it to conduct a horse racing meeting on the leased premises beginning December 17, 1958, through February 14, 1959. This lease was not assignable without the written consent of the lessor. It was executed by Ben Cohen as president of Charles Town.

The negotiations for the second lease were conducted by Byrer representing the owner, and by Ben Cohen on behalf of Charles Town.

Horse racing meets were conducted at the Race Course by Charles Town during the period June 6, 1958, through September 1, 1958, hereinafter referred to as the summer meet, and during the period December 18, 1958, through February 7, 1959, hereinafter referred to as the winter meet. Charles Town's business was operating the track.

When Charles Town filed with the Racing Commission its application for license to conduct the meets, it was required to file a supporitng statement to the application. In the supporting statements, Charles Town represented to the Commission that Charles Town was the applicant; that the name to be used in the operation was "Charles Town Incorporated;" that the race track and racing were to be conducted by a corporation; that Charles Town was that corporation; that its stockholders, officers, and directors were Ben Cohen, Pondfield, and Herman Cohen; that the Fairmount Steel Corporation had "advanced by loan, or otherwise, the capital invested in the business" in the amount of $500,000; and that Herman Cohen, Pondfield, and Ben Cohen had all been interested in the operation of a race track in Baltimore, Md., called the Maryland Jockey Club, in the capacity of president, vice president, and secretary-treasurer, respectively.

Charles Town was duly licensed by the Racing Commission to conduct horse racing meets for the period June 6, 1958, through September 1, 1958, excepting June 16, 1958, through June 21, 1958, and for the Period December 18, 1958, through February 7, 1959, excluding December 25, 1958.

Charles Town maintained its own books of account which included a cash receipts book, a cash disbursements book, a general ledger, and a general journal. These books of account reflected the receipts, disbursements and other accounting entries with respect to the operation of the two racing meets in question. The cash receipts book contained columns which provided for the classification of cash receipts as follows: Parimutuel commissions and surplus; program sales, ad-

missions; parking; concession; and other miscellaneous items.

The cash disbursements book contained columns for the classification of disbursements as follows: track expenses; payrolls; repairs; publicity; programs; travel and entertainment; stationery and printing; office expense; photo-finish; totalisator; film patrol; West Virginia Racing Commission; racing purses; and other miscellaneous entries. Charles Town's books were kept at the offices of the Cohen brothers under the supervision of a bookkeeper employed by them.

During the period July 5, 1958, through February 10, 1959, Charles Town paid $1,741,112.47 to Fairmount. These amounts were reflected as debits to the following accounts on Charles Town's books:

Rent	$ 731,500.00
Account Payable—	
Fairmount Steel Corp.	1,009,612.47
Total	$1,741,112.47

Charles Town maintained bank accounts as follows:

Name of Bank	Title of Account	Date Opened	Date Closed
Peoples Bk. of Charles Town, Charles Town, W. Va.	Regular	May 28, 1958	Nov 11, 1963
Peoples Bk. of Charles Town, Charles Town, W. Va.	Payroll	May 28, 1958	June 16, 1959
Bank of Charles Town, Charles Town, W. Va.	Racing	May 29, 1958	Oct. 31, 1963
Bank of Charles Town, Charles Town, W. Va.	Outs	May 29, 1958	Oct. 31, 1963

The receipts from the operation of both racing meets here concerned were deposited in the regular account of Charles Town in the Peoples Bank of Charles Town,

Charles Town, W. Va., from which account all expenses and charges incident to the operation of both racing meets were paid by Charles Town.

During the period May 28, 1958, through February 17, 1959, deposits in the total amount of $6,523,215.27 were made in the regular account at the Peoples Bank. During the period February 21, 1959, through November 6, 1959, additional deposits totaling $78,-234.80 were made in this account.

During the period May 29, 1958, through February 20, 1959, 847 checks were drawn by Charles Town on the regular account totaling $6,270,972.25. During the period February 24, 1959, through June 17, 1960, 65 additional checks were drawn on the regular account totaling $305,115.47.

Signature cards for these accounts were signed by Herman Cohen, Ben Cohen, and Pondfield.

The payroll account had a $5,000 balance. At the end of the regular payroll period the net payroll would be withdrawn from the regular account and deposited in the payroll account against which the payroll checks would be drawn.

The racing account was used to pay winning purses on races. The necessary amounts were withdrawn from the regular account and deposited in the racing account, against which the checks for this item of expense were drawn.

The outs account was maintained to comply with the provision of state law requiring amounts due on uncashed winning wagering tickets to be kept in a separate account.

Negotiations and correspondence with the Racing Commission concerning the summer and winter meets were transacted in the name of Charles Town by Ben Cohen as president.

A comprehensive liability insurance policy was issued by the Standard Accident Insurance Company covering the period November 1, 1957, to November 1, 1960, to Cohen Brothers, et al., which was a comprehensive policy insuring property of the various Cohen enterprises including:

Bodily injury, except auto
Bodily injury, auto
Property damage, auto
Automobile physical damage

The name of the insured on such policy was set forth as follows: "Herman, Ben, Rosa L. and Zelda G. Cohen, t/a Cohen Brothers and" 21 financially controlled subsidiary corporations (including Housing, Maryland Jockey Club, Fairmount, but not Charles Town).

On May 20, 1958, the policy was extended to cover public liability of Charles Town for hazards such as injury to the public, horse racing, and accidents to participants. This coverage was limited to a maximum amount of $1,000,000. This coverage was in effect during both the summer and winter meets. There was a substantial risk of liability in excess of this amount, due in part, to the fire hazard created by the location of the boiler room in relation to the clubhouse.

Certificates of insurance were furnished to Helene Boyle's insurance company and attorney, stating, *inter alia:*

Name of insured	:	Charles Town, Inc., a West Virginia corporation
Location of works	:	Charles Town, Jefferson Co., W. Va.
Description of operations	:	Thoroughbred Racing and club operations

Coverage of Fairmount under this policy was limited to its operations at New Cumberland, Pa., which involved construction of a housing project.

An endorsement dated June 5, 1958, attached to the comprehensive dishonesty, disappearance and destruction policy issued by the Standard Accident Insurance Company in favor of the Maryland Jockey Club provided that in consideration of an additional premium of $1,837.52, additional insurance was added as follows: "Charles Town, Incorporated, Charles Town, West Virginia, owned, operated and controlled by the owners of the Maryland Jockey Club of Baltimore City, Pimlico Race Course, Baltimore, Maryland." This endorsement was accepted as follows:

/s/ Ben Cohen, Secretary—Maryland Jockey Club of Baltimore

/s/ Ben Cohen, President—Charles Town, Inc.

Charles Town secured jockeys' accident insurance covering both meets and paid the premiums thereon.

The fire insurance covering the premises at the Charles Town Race Track during the time that the two meets here in question were conducted had been se-

cured by the lessor, Helene Boyle. Charles Town paid a pro rata share of the fire insurance premiums for said periods to Helene Boyle.

On June 2, 1958, Charles Town became a member of the Thoroughbred Racing Associations of the United States, Inc., hereinafter referred to as TRA, an organization dedicated to the promotion and maintenance of public interest and confidence in thoroughbred racing. The bylaws of TRA provide that members of TRA shall consist of thoroughbred racing associations duly organized and conducting business in any state, district, or territory of the United States or in Canada. While a member of the TRA, Charles Town paid $7,283.34 and $11,750 as assessments during the periods here involved.

Charles Town entered into contracts with the American Totalisator Division of Universal Controls, Inc., for totalisator services during the periods here involved. The contracts were signed by Ben Cohen, president.

Charles Town received and deposited in its bank account the commissions or royalties due from the catering firm of Harry M. Stevens Company on sales of refreshments at the Race Course during the two racing meets here in question.

All disbursements relative to the operation of the two horse racing meets here involved were made by Charles Town on checks bearing its name.

Charles Town used stationery bearing the name, "Charles Town, Inc., Charles Town Race Course, Charles Town, West Virginia. during the periods here before the Court.

Charles Town maintained a telephone in its own name at the Race Course and paid the telephone charges.

Legal fees incident to organizing Charles Town, and representing Charles Town before the Racing Commission and in other incidental legal matters in connection with the operation of the horse racing meets here concerned, were paid by Charles Town to Martin.

Charles Town filed quarterly report of total earnings of employees with the West Virginia Workmen's Compensation Department for the second, third, and fourth quarters of 1958, and the first and second quarters of 1959, reflecting its business to be "Race Track."

Charles Town filed an election agreement to participate in the Workmen's Compensation Plan of the State of West Virginia for the periods here in question. On the election form, Charles Town stated its business to be "Operation of Race Track and all operations incidental thereto."

Charles Town filed an employer's initial statement with the West Virginia Department of Employment Security for the periods here in question, reporting employment of over 350 employees during a typical week for its reported business of "Thoroughbred Horse Racing."

Charles Town filed annual business and occupation tax returns with the State of West Virginia for the years 1958 and 1959, reporting its business to be "race Track."

Charles Town filed domestic corporation license tax returns with the State of West Virginia for the years 1958 and 1959, stating the kind of business it was engaged in to be "operation of race track."

During the periods here involved, Charles Town operated under an oral agreement with the advertising agency of Kal, Ehrlich & Merrick, Washington D.C., with respect to advertising the racing meets here in question. Monthly billings from June 1958 through February 1959 were sent to Charles Town, thereafter reverting to the Charles Town Race Course, the previous account title.

Charles Town filed Form 941, employer's quarterly Federal tax return, reflecting the following total number of employees employed during each of the indicated quarters:

Quarter	No. of Employees
2d/Q/58	416
3d/Q/58	422
4th/Q/58	339
1st/Q/59	388

Charles Town issued 569-W-2 Forms to persons employed at the Charles Town Race Track during the two meets here in question.

Charles Town paid total payrolls to the persons employed in the operation of the two racing meets here in question in excess of $630,000.

Charles Town paid West Virginia consumers sales tax on parking fees, program sales, and additional charges collected during both of the horse racing meets here in question.

Charles Town contracted, in its name, with the Baltimore & Ohio Railroad Company for the operation of special race track trains to the Race Course during both of the horse racing meets here in question.

In the ordinary course of business, while operating the two horse racing meets here involved during 1958 and 1959, in addition to the contracts specifically mentioned in other paragraphs, Charles Town entered into contracts, oral or otherwise, in its own name and paid its own accounts, among others, with the following companies:

Name of Company	Nature of Service
Central Printing Co.	Printing
Lincoln Maintenance Co.	Track cleaning
Confirmation Photos, Inc.	Photo finish service
Coleman Laboratories	Saliva testing
Shepherdstown Register	Printing
American Bank Stationery Co.	Stationery
Plotkin Tire & Sales	Automotive
White Motor Co.	Automotive
Potomac Light & Power	Electricity
Peoples Water Service Co.	Water
The Kastle Co.	Uniforms
Western Union	Telegraph
Plaza Wine & Liquor	Entertainment

Charles Town filed quarterly Federal excise tax returns, Form 720 and remitted to the Federal admissions taxes due with respect to both horse racing meets here concerned as follows:

Quarter Ending	Amount Paid
6/30/58	$ 7,185.64
9/30/58	22,453.10
12/31/58	3,586.92
3/31/59	10,235.78

Charles Town filed Federal withholding and Federal Insurance Contributions Act (FICA) tax returns,

Form 941, with respect to persons it employed in the operation of both horse racing meets as follows:

Quarter Ending	FICA Taxes Paid	Withholding Taxes Paid
6/30/58	$ 4,518.97	$12,659.57
9/30/58	13,324.10	38,664.57
12/31/58	3,186.73	15,604.82
3/31/59	8,146.06	20,338.74

By letter dated May 28, 1959, Ben Cohen as president of Charles Town closed out the corporation's account with the State compensation commissioner.

Fairmount never filed the information with the appropriate state authority to qualify to do business in West Virginia.

All income and expenses with respect to both race meets were reflected on the books of Charles Town. By means of a journal entry all the income and expenses, with the exception of officers' salaries, were transferred to the books of Fairmount. By means of another journal entry, 10 per cent of the net profits was allocated to Charles Town. These entries were made on June 30, 1958, covering the period of the summer meet through said date which was the end of Fairmount's fiscal year; in November 1958, covering the remainder of the summer meet; and, in the spring of 1959, covering the winter meet.

Fairmount reported on its Federal income tax returns the gross receipts and all the expenses in connection with the operation of the two racing meets. In addition, it claimed a deduction for commission expense representing the 10 percent of the net profits allocated to Charles Town. Fairmount's return for the taxable

year ended June 30, 1959, reflected a net profit of $732,299.86 from the racing meets. By virtue of the available net operating loss carryover it paid no Federal income tax with respect thereto.

On its Federal income tax returns for the taxable periods ended November 30, 1958, and November 30, 1959, Charles Town reported gross receipts in the respective amounts of $64,886.53 and $26,051.87, which amounts represented the 10 percent allocated to Charles Town and which corresponded with the deductions claimed by Fairmount for commission expense.

On its Federal income tax return for the taxable period ended November 30, 1958, Charles Town claimed a deduction in the amount of $40,000 for compensation of officers as follows:

Louis Pondfield	$25,000
Herman Cohen	7,500
Ben Cohen	7,500

In addition, it claimed a deduction of $1,000 for a contribution to the Herman and Ben Cohen Charitable Foundation, Inc.

On its Federal income tax return for the taxable year ended November 30, 1959, Charles Town claimed a deduction in the amount of $20,000 for compensation paid to Pondfield. In addition, it claimed relatively small amounts for other deductions, including $200 for contributions to the Herman and Ben Cohen Charitable Foundation, Inc.

The income and expenses of the two horse racing meets here concerned were reported only on the Federal income tax returns of Charles Town and Fairmount. No partnership information returns were filed with the Internal Revenue Service reflecting any of the income or expenses of the two horse racing meets here concerned.

Fairmount and Charles Town never declared or paid formal dividends on the capital stock they issued.

On July 29, 1959, Charles Town instituted an action in the Circuit Court of Jefferson Couty, West Virginia, against Helene Boyle to recover an alleged overpayment of rental due in accordance with the provisions of the second lease. As a result of said litigation, Helene Boyle, on November 6, 1959, paid to Charles Town the sum of $38,698.82, which amount was deposited by Charles Town in its regular account at the Peoples Bank, Charles Town, W. Va.

On March 26, 1959, Fairmount paid to C. B. Associates $400,000 which was debited on Fairmount's books to the account entitled "Loans Payable #1." On September 29, 1959, Fairmount received from C. B. Associates $100,000, which was credited to the account entitled "Loans Payable #1'."

As of September 29, 1959, $600,000 of the $900,000 advance made by Housing to Fairmount was still outstanding. At this time C. B. Associates had succeeded Housing. This amount of $600,000 was repaid as follows: a $5,000 cash payment and, by applying $595,000 against the purchase price of $654,867.13 payable by C. B. Associates to Fairmount for Fairmount's interest in a partnership with Forest Hill Village, Inc., known

as Forest Hill Village, which partnership interest was assigned by Fairmount to C. B. Associates on March 28, 1962.

Charles Town Properties, Inc., hereinafter sometimes referred to as Properties, is a corporation incorporated on April 19, 1958, under the laws of the State of West Virginia.

On April 24, 1959, Properties entered into a contract with Helene Boyle for the purchase of the Race Course.

On or about May 7, 1959, Properties closed the contract for the purchase of the Charles Town Race Track and acquired said race track. On or about May 19, 1959, there were issued and outstanding 10 shares of the capital stock of Properties, which 10 shares were acquired by Pondfield on the same date for a consideration of $1,000. The previous directors of Properties tendered their resignations, and Pondfield, Herman Cohen, and Ben Cohen became the directors of Properties on said date.

On the same day the following officers of Properties were elected:

President	Ben Cohen
Vice President	Louis Pondfield
Secretary-Treasurer	Herman Cohen

On or about May 19, 1959, additional shares of the capital stock of Properties were issued upon payment of the sum of $9,000 as follows:

Name	No. of Shares
Ben Cohen	5
Carroll A. Weinberg, Charlotte Cohen Weinberg, and Zelda G. Cohen, Trustees for the Descendants of Charlotte Cohen Weinberg	20
Richard S. Davison, Rosalee Cohen Davison, and Zelda Cohen, Trustees for the Descendants of Rosalee Cohen Davison	20
Ben Cohen, Herman Cohen, and Stanley H. Wilen, Trustees for the Descendants of Nathan L. Cohen	45

No additional captial stock of Properties has been issued since that time. Since that time and until the present, Properties has owned and operated the Charles Town Race track and there has been no change in the ownership.

On May 20, 1959, the Equitable Trust Company of Baltimore, Md., loaned $2,000,000 to Properties, bearing interest at 5 percent per annum. Cohen brothers participated in the loan to the extent of $1,500,000. The note for $2,000,000 executed by Properties to the Equitable Trust Company was endorsed by Ben Cohen and Herman Cohen. These funds were used by Properties for the purchase of the Race Course.

Fairmount was liquidated on June 1, 1962, and has since then been dormant.

The minutes of the annual meeting of stockholders of Charles Town held on May 15, 1961, provide in part as follows:

> The Corporation has finished its racing season and has concluded its arrangements with Fairmount Steel Corporation according with the agreements previously entered into. Mr. Louis Pondfield stated that the two (2) shares heretofore held in the names of Herman Cohen and Ben Cohen had been returned to him in view of the completion of the arrangement with Fairmount Steel Corporation.
>
> * * * * *
>
> The meeting then proceeded to the election of Directors for the ensuing year or until their successors are duly elected and qualified. Upon motion duly made, seconded, and passed, the following were elected:
>
> Louis Pondfield
> John J. Pondfield
> Rose Pondfield

Charles Town never conducted any business other than the operation of the two racing meets in question and was a dormant corporation at the time of the trial of this case.

In a statement attached to the deficiency notice the respondent explained his adjustments for the period May 22, 1958, to November 30, 1958, as follows:

(a) Additional income $497,833.02

It is held that income in the amount of $2,808,220.18, included in the return of Fairmount Steel Corporation for the taxable year ended June 30, 1959, constituted additional income to you under the provisions of section 61 and section 482 of the Internal Revenue Code of 1954, resulting in additional taxable income in the amount of $497,833.02, computed as follows:

Mutuel Dept. Commission	$2,389,657.03
Mutuel Dept. Breakage	220,678.86
Programs	21,837.60
Grandstand	51,984.45
Clubhouse	49,208.81
Box Seats	8,958.64
Club House Complimentary	9,878.13
Concessions	43,773.12
Valet parking	8,824.25
Miscellaneous Income	3,254.80
Federal Admission	164.49
Total Income	$2,808,220.18
Less: Total Expenses	2,308,885.46
	$ 499,334.72
Less: Unknown Difference	1,501.70
Additional income from Charles Town Race Track	$ 497,833.02

A similar explanation was made for the additional income of $234,466.84 for the fiscal year ended November 30, 1959.

Ultimate Findings of Fact

Charles Town was organized for the purpose of conducting the racing meets in question in its own right.

Charles Town performed substantial income-producing activities.

The total net income derived from the operation of the two racing meets in question was produced and earned by Charles Town.

The respondent, in allocating the income reported by Fairmount from these racing meets to Charles Town, did not act unreasonably, arbitrarily, or capriciously.

Said determination of the respondent was necessary in order to prevent the evasion of taxes and to clearly reflect the taxable income of Charles Town, within the meaning of section 482 of the 1954 Code.

The advances to Charles Town by Fairmount constituted in substance an equity investment.

OPINION

The question presented is whether net income in the amounts of $497,833.01 and $234,466.84, representing 90 percent of the profits derived from the operation of two horse racing meets during the years 1958 and 1959, is taxable to Fairmount, as petitioner contends, or to Charles Town, the petitioner, as the respondent has determined. We agree with the respondent that the said net income is taxable to Charles Town.

The answer to the question depends upon the legal effect of the May 20, 1958, agreement between Fairmount and Charles Town, which agreement we have set out in full in our findings. Under this agreement Fairmount

was to furnish the necessary capital with which to conduct the meets and Charles Town agreed to operate the meets "for the benefit of Fairmount" and to receive for this operation 10 percent of the net profits for its services. On its face, the agreement has the appearance of a pure agency. But when we look at how the racing meets were actually conducted the agency feature melts away.

First, Ben Cohen, in obtaining the lease of the race track property from Helene Boyle, acted not for Fairmount but "for Charles Town Incorporated, a corporation to be hereinafter created." Nowhere in the lease was Fairmount ever mentioned. The lease was the property of Charles Town. As rental for the leased property the lease provided that "said Lessee [Charles Town, not Fairmount] shall pay to the Lessor the sum" of $225,000. The lease was made subject to the express condition that the lessee "shall be able to secure from, and be granted, a license by, the West Virginia Racing Commission" permitting the lessee to conduct a horse race meeting on the leased premises. In applying for the license, Charles Town gave no indication that it was acting as agent for another. The Racing Commission granted the license to Charles Town and authorized Charles Town to hold race meetings on Charles Town's premises.

Charles Town operated the property as if it was its own. It secured the leases; it secured the licenses; it hired all the employees; it collected all the receipts; it paid all the expenses; it entered into written and oral contracts in its own name for materials and services needed to conduct the meets; it filed all the necessary State and Federal reports; it joined TRA, an association

of race track operators; it sued the lessor in its own name for excessive rent allegedly paid to the lessor; and in fact it did all the things necessary to earn the income in question. Charles Town's activities were not the usual activities of an agent and its business purpose was not the carrying on of the normal duties of agent but, rather, to conduct and operate the race track meets in its own right.

We think the facts and principles here are very much like the facts and principles involved in *National Carbide Corp. v. Commissioner,* 336 U.S. 422. In that case the taxpayers were three wholly owned subsidiaries of another corporation, Airco. The taxpayers and Airco *had entered into contracts* which provided, in substance, that the subsidiaries *were employed as agents* to manage and operate plants designed for the production of products assigned to it, and *as agents* to sell the output of the plants. *Airco was to furnish working capital,* executive management, and office facilities. The subsidiares *were to pay Airco all profits in excess of 6 percent on their outstanding capital stock,* which in each case was nominal in amount. Title to the assets utilized by the subsidiaries was held by them, and the amounts advanced by Airco for the purchase of assets and working capital *were shown on the books of the subsidiaries as accounts payable to Airco.* No interest ran on these accounts.

The profits turned over by the taxpayer subsidiaries to Airco were reported as income on Airco's returns. The taxpayers reported as income only the 6 percent return on capital specified in the contracts. The Commissioner determined that the taxpayers were taxable on the income turned over to Airco as well as on the

nominal amounts retained. The Court sustained the Commissioner's determination and *rejected the taxpayer's contention that they acted merely as agents of Airco.*

In so holding, the Court noted that the fact that Airco furnished the funds necessary to acquire the assets held by the taxpayers did not detract from the reality of their ownership of such assets. Moreover, the Court held that it made no difference whether the funds advanced constituted capital contributions or loans—the important fact was that the taxpayers held title to the assets and regardless of the characterization of the source of the funds, it could not make the income earned by the utilization of the assets the income of Airco, the supplier of the funds. In so holding, the Supreme Court stated:

> We think that it can make no difference that financing of the subsidiaries was carried out by means of book indebtednesses in lieu of increased book value of the subsidiaries' stock. A corporation must derive its funds from three sources: capital contributions, loans, and profits from operations. The fact that Airco, the sole stockholder, preferred to supply funds to its subsidiaries primarily by the second method, rather than either of the other two,[15] does not make the income earned by their utilization income to Airco. We need not decide whether the funds supplied to petitioners by Airco were captial contributions rather than loans. It is sufficient to say that the very factors, which, as petitioners contend, show that Airco "supplied" and "furnished" their assets also indicate that petitioners were the recipients of capital contributions rather than loans.[16]

> Nor do the contracts between Airco and petitioners by which the latter agreed to pay all profits above a nominal return to the former, on that account, become "agency" contracts within the meaning of our decisions. The Tax Court felt that the fact that Airco was entitled to the profits by contract shows that the income "belonged to Airco" and should not, for that reason, be taxed to petitioners. Our decisions requiring that income be taxed to those who earn it, despite anticipatory agreements designed to prevent vesting of the income in the earners, foreclose this result. Lucas v. Earl, 1930, 281 U.S. 111 * * *
>
> What we have said does not foreclose a true corporate agent or trustee from handling the property and income of its owner-principal without being taxable therefor. Whether the corporation operates in the name and for the account of the principal, binds the principal, by its actions, transmits money received to the principal, and whether receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal[19] are some of the relevant considerations in determining whether a true agency exists. If the corporation is a true agent, its relations with its principal must not be dependent upon the fact that it is owned by the principal, if such is the case. Its business purpose must be the carrying on of the normal duties of an agent.[20] * * * [Footnotes omitted.]

Application of the standards set forth by the Supreme Court in *National Carbide* to determine the existence of a true agency relationship reveals that the

agency form here was a mere facade and that such a relationship did not exist as a matter of substance. The evidence clearly established that Charles Town, the purported agent, did not operate in the name and for the account of Fairmount, it did not bind Fairmount by any of its actions, did not transmit money received to Fairmount on a regular and preestablished basis, nor was the receipt of income attributable either to the employees or assets of Fairmount. Finally, and conclusively, Charles Town's business purpose was not the carrying on of the normal duties of agent. Its business purpose, as revealed in its certificate of incorporation and by the testimony of both Ben Cohen and Pondfield was to conduct horse racing meets, with no limitation that such activity be conducted in the capacity as agent for another. Significantly, its charter does not authorize it to conduct business in the capacity of an agent.

There is a factual distinction between *National Carbide* and the instant case which we think is of no importance. In *National Carbide,* Airco, the alleged principal, owned *all* the stock of the three subsidiaries, the alleged agents. Here, Fairmount, the alleged principal, owned *no* stock in Charles Town, the alleged agent. Ninety-eight percent of the issued and outstanding stock of Charles Town was owned by Pondfield for which he paid $980 on July 22, 1958. This technical ownership of stock and the small capital furnished by him are, we think, of little importance when compared with the *control* exercised, and the capital arranged for, by Ben and Herman Cohen. These two brothers controlled and dominated a group of organizations, including Housing, Fairmount and Charles Town. They caused Charles Town to be incorporated. They

caused Housing to turn over to Fairmount, who was then insolvent, $900,000 so that Fairmount could furnish to Charles Town the capital necessary to conduct the two contemplated racing meets. Fairmount actually advanced to Charles Town $986,525 for that purpose. We think it is obvious that what the Cohen brothers were trying to accomplish was to arrange the operation of the racing meets in such a way that at least the greater part of the earnings from the meets would be the income of Fairmount, so that Fairmount could take advantage of the net operating loss carryovers in the total amount of $852,105.37 and thus pay no tax on the income from the meets until that sum was realized. The Cohens evidently did not want Fairmount to carry on the actual operations. They organized Charles Town for that purpose and by the agreement dated May 20, 1958, attempted to create a principal-agent relationship between Fairmount and Charles Town. For reasons previously given we do not think a true agency relationship was thus created. *National Carbide Corp. v. Commissioner, supra; Spicer Theatre, Inc.*, 44 T.C. 198, affd. 346 F. 2d 704 (C.A. 6, 1965).

See also *Fairmount Park Raceway, Inc. v. Commissioner*, 327 F. 2d 780 (C.A. 7, 1964), affirming a Memorandum Opinion of this Court. In that case a group of individuals formed a partnership which obtained a lease of a race track. The same individuals formed a corporation which, as indicated in the minutes of a meeting of its board of directors was "to function only as an agent" for the partnership in the operation of racing meets under a sublease from the partnership. These minutes further indicated that the corporation will serve only "as the agent of the partnership, be sup-

plied with operating and construction funds by the partnership, and will account to the partnership for all actions taken and monies expended on its behalf."

The partnership subleased the race track to the corporation, which during the years before the Court provided that 100 percent of the net profits from the operation would be paid over to the partnership as rental.

Applications for race meetings were filed with the state racing commission by the corporation in its name. At the end of a racing meet, the corporation paid its entire net income over to the partnership, deducted these amounts as "rent," which amounts were reflected as rents received in the partnership returns.

The amounts claimed as rent by the corporation were disallowed in part by the Commissioner as being excessive. The taxpayer contended, in part, that the corporation was the agent of the partnership and that a proper way to ascertain a reasonable rental for the property was to determine the amount of the corporation's earnings the partnership would allow the corporation to retain as compensation for operating the track.

In rejecting the contention that the corporation was a mere agent, the U.S. Court of Appeals, Seventh Circuit, said:

> The Tax Court could properly reject the notion advanced that the corporation was in reality—considering the investments of the partners in the track and the corporation's use of the partners' borrowing power, and its capital of only $17,500.00—merely an agency of the partners which was entitled not to the earnings the Commissioner determined for it, but really entitled to only a fee. The

> "business purpose" of the corporation was operation of the track in its own right and not the normal duties of an agent. National Carbide Corp. v. Commissioner, 336 U.S. 422, 437 * * *. By the lease it appears that the partnership chose to avoid the burdens of principalship. 336 U.S. at 438, 69 S.Ct. at 734.

In the instant case, we think the business purpose of Charles Town was the operation of the track in its own right and not the normal duties of an agent and that Fairmount chose to avoid the burdens of principalship.

There are, of course, other considerations that require comment. For instance the large payments made by Fairmount to Charles Town, although reflected on Charles Town's books as accounts payable, were definitely not loans and petitioner does not so contend. In fact, in paragraph 18 of its requested findings of fact, it requested us to find that "The said advances to petitioner were not made to it as a loan." The payments were not evidenced by any notes or other debt instruments, did not bear interest, were made without security, and with no date for repayment. In fact, according to the agreement between Fairmount and Charles Town, if the payments were lost, "any loss shall be borne entirely by Fairmount." The Supreme Court, in *National Carbide Corp. v. Commissioner, supra,* said that a corporation must derive its funds from three sources, namely, (1) capital contributions, (2) loans, and (3) profits from operations. The payments here were not from class (3) and, since they were not loans, they must be regarded as capital contributions. Although the Supreme Court in *Nation-*

al Carbide Corp. v. Commissioner, supra, said it was not necessary in that case to decide whether the funds supplied by Airco were capital contributions or loans, it said by way of *obiter dictum* that the facts "indicate that petitioners were the recipients of capital contributions rather than loans" and, in footnote 16, said in part:

> Since no interest ran on these accounts, the "loans" were identical, except in name, with contributions of capital. [citing several cases]

In holding that the payments made by Fairmount to Charles Town were capital contributions, it is immaterial that Fairmount itself was not a stockholder of record in Charles Town. *Motel Co. v. Commissioner,* 340 F. 2d 445 (C.A. 2, 1965), affirming a Memorandum Opinion of this Court; *Sherwood Memorial Gardens, Inc.,* 42 T.C. 211, affd. 350 F. 2d 225 (C.A. 7, 1965).

Petitioner makes a belated argument to the effect that it and Fairmount were joint venturers. That is not the way the contract between them was drawn. The agreement was that Charles Town was to operate the race track "for the benefit of Fairmount" except that "Charles Town shall receive 10 per cent (10%) of the profits for its services." This is not the language of a joint venture. The parties did not hold themselves out to the public as joint venturers. Much that we said of the pure agency relationship can be repeated here. The fact that the parties treated the income returned by Charles Town as "commissions" is further indicative that the parties were not joint venturers. Under West Virginia case law, a joint ven-

turer is considered to be a limited partner. *Horchler v. Van Zandt,* 120 W. Va. 452, 199 S.E. 65 (S. Ct. App. 1938). No partnership returns were filed. The only returns that were filed were those of Fairmount and Charles Town as separate corporations. We hold that Fairmount and Charles Town were not joint venturers.

It follows from all of the foregoing that Charles Town earned the income in question. The attempted shifting of this income to Fairmount may properly be corrected by the application of the provisions of section 482 of the 1954 Code.[1]

Petitioner contends that there was insufficient common control existing between Fairmount and Charles Town to sustain the applicability of section 482 to this case. In support of this position petitioner states that the agreement which provided for the Cohens' control of Charles Town, by placing both Herman and Ben on the board of directors of Charles Town, also provided for the division of income between Charles Town and Fairmount, and that as section 482 applies only to transactions "between *already* controlled taxpayers," control required for the application of section 482 is wanting. The only authority cited in support

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[1]Sec. 482. ALLOCATION OF INCOME AND DEDUCTIONS AMONG TAXPAYERS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary of his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such orgainizations, trades, or businesses.

of this position is section 1:482-1 (c)[2] of the regulations. A perusal of that section reveals that it sets forth the general circumstances in which the Commissioner's authority under section 482 may be exercised. Of itself, it lends no support to petitioner's position.

Petitioner is in error in assuming that only by virtue of the agreement between it and Fairmount were the Cohens endowed with control of Charles Town. That was only one of several facts, previously mentioned herein, by which their actual and effective control of the corporation was acquired and exercised.

The statute speaks in terms of organizations "owned or controlled *directly or indirectly* by the same interests." [Emphasis supplied.] Furthermore, the term "controlled" as used in section 482, " 'includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise.' " *L. E. Shunk Latex Products, Inc.*, 18 T.C. 940, 956.

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[2] §1.482-1 DETERMINATION OF THE TAXABLE INCOME OF A CONTROLLED TAXPAYER.

(c) *Application.* Transactions between one controlled taxpayer payer and another will be subjected to special scrutiny to ascertain whether the common control is being used to reduce, avoid, or escape taxes. In determining the true taxable income of a controlled taxpayer, the district director is not restricted to the case of improper accounting, to the case of a fraudulent, colorable, or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income, deductions, credits, or allowances. The authority to determine true taxable income extends to any case in which either by inadvertence or design the taxable income, in whole or in part, of a controlled taxpayer, is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

No serious question can arise as to the control of both Fairmount and Charles Town by the Cohen brothers. That they owned all of Fairmount's voting stock alone establishes their control of that entity. Their actual control of Charles Town is made evident by the facts of record disclosing that they constituted, at all times material, the majority of the board of directors of Charles Town; that they caused its creation; were principal officers of the corporation and active in its management; that they caused the capital necessary to conduct the meets to be furnished to Charles Town; and, by the fact that as the majority of the officers of Charles Town, they were, according to the May 20, 1958 agreement, to "make all major decisions as to the allocation of income and expenses in the management of the race meet."

The shifting of profits from one controlled entity to another for the purpose of utilizing a net operating loss carryover, as is the situation here, warrants the reallocation of that income under the provision of section 482. *Spicer Theatre, Inc., supra.*

The respondent's determination is sustained.

Decision will be entered
for the respondent.

Decision.

Tax Court of the United States
Washington

Charles Town, Incorporated, Petitioner, v. Commissioner of Internal Revenue, Respondent. Docket No. 3517-62.

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion, filed January 19, 1966, it is

Ordered and Decided: That there are deficiencies in petitioner's income tax for the period May 22, 1958, to November 30, 1958, of $258,616.93, and for the fiscal year ending November 30, 1959, of $117,367.57.

(Signed) C. R. Arundell
Judge.

[Seal]

Entered Jan. 19, 1966.

Portions of the Evidence.

STIPULATION OF FACTS

* * * * * *

7. The issued and outstanding stock of Charles Town consisted of 100 shares of common stock issued by certificates dated May 22, 1958, as follows:

Certificate No.	Issued To	No. of Shares
1	Herman Cohen	1
2	Ben Cohen	1
3	Louis Pondfield	98

Said stock was issued for the total sum of $1,000.00 which was paid as follows:

Date Paid	Payor	Amount
July 22, 1958	Herman Cohen	$ 10.00
July 22, 1958	Ben Cohen	10.00
July 22, 1958	Louis Pondfield	980.00

During the taxable periods of Charles Town, here before the Court, no additional stock was issued to any person and the aforementioned 100 shares represented all of the issued and outstanding stock during said periods of time.

* * * * * * *

24. By check dated May 20, 1958, Fairmount paid the sum of $225,000.00 to Helene W. Boyle, which payment was reflected on Fairmount's books as a debit

to an account entitled "Charles Town, Inc." and as a credit to Cash.

* * * * * *

27. In addition to the foregoing, the following amounts were paid by Fairmount to or on behalf of Charles Town on the dates indicated, which amounts were all reflected on Fairmount's books as debits to the account "Charles Town, Inc." and as credits to cash:

May 26, 1958	$5,000.00
May 26, 1958	5,000.00
May 28, 1958	2,025.00[1]
May 28, 1958	$ 1,000.00
May 28, 1958	1,000.00
May 28, 1958	225,000.00
November 5, 1958	224,250.00[2]
November 5, 1958	$63,250.00[3]
December 5, 1958	$200,000.00
November 24, 1959	20,000.00

[1]This sum represented the payment of a deposit to the Workmen's Compensation Fund of West Virginia, which sum was reimbursed by Charles Town to Fairmount on June 10, 1958.

[2]Payable to the Citizens National Bank of Martinsburg, West Virginia.

[3]Payable to Helene W. Boyle.

* * * * * *

67. Charles Town paid the following sums to Fairmount on the indicated dates, said payments being reflected on Charles Town's books as credits to cash

and as debits to the general ledger account titled as indicated:

Date	Amount	Account Debited
July 5, 1958	$100,000.0	Rent
July 12, 1958	140,000.00	"
July 24, 1958	137,000.00 (Posted in the amount of $130,000)	Account payable—Fairmount Steel Corp.
		" "
Aug. 9, 1958	100,000.00	" "
"	150,000.00	" "
Aug. 20, 1958	150,000.00	" "
Sept. 1, 1958	225,000.00	" "
Nov. 17, 1958	54,612.47	" "
Jan. 12, 1959	200,000.00	" "
"	63,250.00	Rent Expense
Feb. 3, 1959	178,250.00	" "
Feb. 10, 1959	250,000.00	" "
Dec. 1, 1959	30,000.00	Advance from Fairmount Steel Corp.

An amount of $20,466.85 as of June 12, 1959, is reflected in the cash receipts book of Fairmount and is credited there to the account entitled "Charles Town, Inc." No disbursement of said amount is reflected in Charles Town's cash disbursements book.

* * * * * *

(4)

BENJAMIN BRILLIANT
DIRECT EXAMINATION

By Mr. Altman:

* * * * * *

(47) Q. Mr. Brilliant, in paragraph 67 of our stipulation (48) there is a reference to a figure of $137,000 which was posted in the amount of $130,000. Can you explain the difference? A. Yes. When they started the operations at Fairmount Steel, they needed several bank accounts. They opened up one account called "Pay Roll Account" for $5,000, another account called "The Horseman's Account" for $1,000 and another account for $1,000 called the "Outs Account." That was $7,000 that was not credited to the advance account shown on Fairmount Steel's books.

Q. In the same paragraph of the stipulation, Mr. Brilliant, there is a reference to an amount of $20,466.85, stating that no disbursement of said amount is reflected in Charles Town's cash disbursements book. Can you explain that? A. You mean it is Charles Town's disbursements book, I think you said Fairmount Steel.

Q. No, Charles Town. A. Those very same accounts were closed out and I closed them out by journal entry although a check was issued to close them out. There was a check for $5,019.80 to close out the pay roll account. $1,000 to close out the Horsemen's Account. $1,000 to close out the "Outs" account, and there was something like $13,000-some odd from the regular account also transferred at the same time. Those four checks added together made up that $20,000 figure that you referred to.

(49) And the journal entry was made to cancel them out instead of going through the cash disbursements book of Charles Town.

* * * * * *

CROSS EXAMINATION

(50)

By Mr. Seigel:

* * * * * *

(55) Q. Now, do you know what the financial condition of Fairmount was at the time of that advance of $900,000? (56) A. Fairmount Steel, I believe, had a deficit.

Q. In other words, are you saying it was insolvent at that time as a matter of book entries? A. As far as the books were concerned, it may have been insolvent but I do not think it was actually insolvent.

* * * * * *

(71) Q. That was $200,000 paid by whom to whom, do you recall? A. Fairmount Steel advanced Charles Town $200,000 for its operations for that fall meet.

Q. Do you know what that $200,000 was used for? A. For a bank roll.

Q. What is a bank roll? A. The track has to have cash money on hand to start operating with. They call it a "bank roll."

Q. That is necessary to commence a day's betting, in effect, wagering? (72) A. Right. To start the track's operations.

Q. That money was advanced by Fairmount to Charles Town? A. That is correct.

* * * * * *

(74)

LOUIS PONDFIELD

a witness called by counsel for the Petitioner, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

By Mr. Altman:

* * * * * *

(75) Q. What business are you in now? A. Race track management.

Q. What race track is that? A. Well, I manage Charles Town Race Course, and the Pimlico Race Track.

Q. How long have you been in that business? A. Since 1949.

In actual management.

Q. How long have you had any connection with horse racing? A. I have had connection with horse racing all my life actually, or since I was old enough to do it.

Q. Well, before 1949 what was your connection with horse racing? A. Well, from about 1920 I owned race horses and raced them. I was close to management. I was friendly with management, and bred some horses a little bit later on which I do presently.

Q. You do what? A. I bred some horses. I run a breeding farm.

Q. I see. Now, referring to 1949, what connection to you have from there on— A. 1949 I entered into negotiation to purchase Randall Park, a race track in Cleveland, Ohio.

(76) Q. Can you state how that negotiation developed? A. Well, actually another group of people including myself, purchased it. In 1950, that is.

Q. What interest did you acquire in it? A. Eventually I wound up with 10 per cent of it, and a management contract.

Q. What was your part in the negotiation? A. I think I spearheaded the complete negotiation such as we set the price, means of amortization, down payment, rate of interest—who was to be employed, and all that sort of thing—everything.

Q. Did you have any part in the operation? A. Yes, sir, I completely operated it or I managed it rather.

Q. Were Herman and Ben Cohen connected with that? A. No, sir.

Q. I mean, in the acquisition? A. No. They had nothing to do with it. However, I did discuss the acquisition of that race track prior to the final deal that we did make.

Q. With whom? A. Well, you mean the prospective purchaser?

Q. Yes. A. That was Sol Silberman and Ralph De Chiaro and Herman Siskind, and myself.

(77) Q. Were those the actual purchasers? A. Well, no, I was to participate in it and the other three gentlemen were the actual purchasers. Four in the corporation.

Q. Did you enter into negotiations in connection with the acquisition of any racing track after that? A. Yes, I have been in a number of negotiations prior to and since then.

Q. Prior to when? A. 1949.

Q. In other words, I have been in some negotiations to buy race tracks which were never effected.

Q. Prior to 1949? A. Right.

Q. Now, since 1949, can you give me chronologically just what you did? A. Yes, sir. In 1951 I arranged a group which consisted of Cully Boshamer, Mack Lesnich and myself, and we purchased two race tracks in the Cleveland area, namely, Thistle Downs and Cranwood.

Q. Did you have any connection with their operation? A. Yes, I managed that, too.

Q. Did Herman or Ben Cohen have any connection with that? A. None.

Q. After that were there any? (79) A. Well, in 1951 I initiated some negotiations whereby the Maryland Jockey Club or the Pimlico Race track.

Q. Well, now what is the difference between those two? Is the Maryland Jockey Club— A. The Maryland Jockey Club operates the Pimlico Race track.

Q. As lessee or owner? A. Actually they are owners. And the "Pimlico Race Course" is just a name.

Q. I see. Are the Cohens, were they involved in that? A. They finally entered into that negotiation. In other words, it was initiated by myself and then Cully Boshamer and Mack Lesnich and the Cohen Brothers.

Q. Did you acquire an interest in it? A. Yes, sir.

Q. What percentage? A. I presently own 7½ per cent of it.

Q. Have there been any others since then? A. We tried to buy a few other race tracks.

* * * * * *

(85) Q. In your management of the Charles Town Racing meets, did you get any interference from the Cohens? A. None whatever.

(86) Q. Do you know why they were placed on the Board of Directors under this contract? A. It was a mutual idea. It was both their idea and mine, so that they could vote and I could not—and it would be a little unfair if I walked in there and spent a half million dollars for an improvement for a race track that did not belong to use so, naturally, they were in a position to out vote me on the Board of Directors and the only time I ever conferred with them was a matter of policy, important policy or some expenditures, large expenditures, aside from the daily operation.

* * * * * *

(87) Q. Mr. Pondfield, again in your opinion, based on your experience in the racing business, was the ten per cent for operation received by Charles Town, Inc., a fair compensation for the operation? A. I can only tell you that in 1950 I had an arrangement similar to that with Randall Park, the race track in Cleveland, Ohio, where I was to get 10 per cent of the net profits at the end of the year.

(The Court) Why not answer the question directly then?

By Mr. Altman:

Q. Yes, my question was— A. If you will put it again.

Q. —was ten per cent a fair compensation for the operation? (88) A. Yes, sir.

* * * * * *

(129) BEN COHEN

a witness called by the Petitioner having been duly sworn, testified as follows:

DIRECT EXAMINATION

By Mr. Altman:

* * * * * *

(129) Q. At the time you went into the deal that—this contract that you just looked at with Charlestown, Incorporated, did you anticipate at that time more than one racing meet? A. There was only one racing meet that we anticipated. That is all we negotiated for.

* * * * * *

(129) Q. Showing you exhibit 18-R, can you identify that—(130) being supporting statement to the application for license for the second meeting, I ask you again were you able to find the copy for the first meet? A. No.

Q. Now, let me ask you whether there is any similarity between this supporting statement for the second meet and the one that was filed for the first meet? A. They are the same. The forms are the same, the questions and answers are the same.

CROSS EXAMINATION

By Mr. Seigel:

* * * * * *

(144) (The Court) How was it put, just you gave a check as the money was needed?

(The Witness) Yes, sir.

In other words, when this lease was signed, I did not have a Fairmount check but I happened to have a

check on the bank. I wrote in Fairmount's name and put the money up, the $225,000. Then when they opened the account, in the "Ins" and "Outs" account and the payroll account, we advanced them the money for that.

(The Court) You mean now Fairmount?

(The Witness) Fairmount advanced it. Then when they needed the bank roll, which is the amount of money that you get in different denominations, so that the cashiers can cash tickets without running over to the seller to get the money to hold up the business, we advance $200,000 and when Charles Town accumulated enough money of their own as they did for the out moneys that come in daily, they paid back the $200,000 for the bank roll and then at a later date they paid back the other money as it accumulated because in the first place, Fairmount could use the money and the other thing is that it was a small bank up in Charles Town and you do not like to leave fifty or one hundred thousand dollars in a bank that only has about $50,000 (145) capital.

* * * * * *

(156) Q. Did Fairmount Steel have any business activity in the area of New Cumberland, Pennsylvania? A. Yes.

Q. What was that activity? A. That was a Capehart Housing job which Fairmount was using our money for. It required a million four hundred thousand dollars. It was a construction job, built for the Army under competitive contract.

Q. Fairmount wound up with a profit on it? A. Yes.

* * * * * *

[JOINT] EXHIBIT 3-C

Corporation Income Tax Return

Name Fairmount Steel Corporation

Calendar Year ————————

Or fiscal Year Begun July 1, 1958 and Ended June 30, 1959

Schedule L.—Balance Sheets (See Instructions)

Assets	Beginning of Taxable Year Amount	Total
1. Cash		$9,000.00
2. Notes and accounts receivable	$384,453.98	
(a) Less: Reserve for bad debts		384,453.98
3. Inventories: (a) Other than last in, first-out	.....	
(b) Last-in, first-out	.....	
4. Prepaid expenses and supplies		624.88
5. Investments in governmental obligations:		
(a) Obligations of a State, Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia	.....	
(b) Obligations of the United States and its instrumentalities		.....
6. Mortgage and real estate loans		50,000.00
7. Other investments, capital stock joint venture		493,013.13
8. Buildings and other fixed depreciable assets	4,366.32	
(a) Less: Accumulated amortization and depreciation	94.59	4,271.73
9. Depletable assets	.....	
(a) Less: Accumulated depletion		.....
10. Construction in progress		765,201.84
11. Intangible assets (amortizable only)	.....	
(a) Less: Accumulated amortization	.....	.....
12. Other assets (Attach schedule) org. expense		497.35
13. Total Assets		1,707,062.91

* * * * * *

[JOINT] EXHIBIT 17-Q

No. 3

Under Act 1935

WEST VIRGINIA RACING COMMISSION

License

This is to Certify, That on the 21st day of May of 1958 a license was granted to CHARLES TOWN, INC., by which it is authorized to hold race meetings on its premises at Charles Town, West Virginia.

From June 6, 1958 to September 1, 1958, inclusive excepting June 16th through June 21st.

This License is issued with the conditions stipulated as follows:

FIRST. No racing official shall act at its meeting except by approval of the West Virginia Racing Commission.

SECOND: All race meetings conducted under this license shall be subject to the rules, regulations and conditions, from time to time, prescribed by the West Virginia Racing Commission and may be revocable for any violation thereof, or whenever the continuance of such license may be deemed not conducive to the best interests of racing.

JAMES G. McCLURE, Chairman.

W. D. POLAND, Secretary.

[JOINT] EXHIBIT 18-R

SUPPORTING STATEMENT TO APPLICATION FOR LICENSE

All questions must be answered in full. This statement is to be considered as a part of the printed form for Application for License. Fill in and execute in quadruplicate, and send with printed form to:

West Virginia Racing Commission
Capitol Building
Charleston 5, West Virginia

1. Name and address of applicant.
CHARLES TOWN INCORPORATED

(a) Name to be used in the operation

CHARLES TOWN INCORPORATED

2. Is the race track and racing to be conducted by an individual, a partnership, or a corporation?

Corporation

(b) If a *corporation,* give the following:

Date of Incorporation	State in which Incorporated	Authorized Capital	Paid-in Capital
May 22, 1958	West Virginia	$10,000	$1,000

Names and Addresses of Officers and Directors	Title
Ben Cohen, 1229 Mt. Royal Ave., Baltimore 17, Md.	President & Director
Louis Pondfield, 1229 Mt. Royal Ave., Baltimore 17, Md.	Vice-Pres. & Director
Herman Cohen, 1229 Mt. Royal Ave., Baltimore 17, Md.	Secy-Treas. & Director

Page Two

2. (b) Continued.

Give below the names and address of all stockholders as well as all beneficial owners of such stock, and shares held by each:

Names and Addresses	Shares Held
Louis Pondfield, 1229 Mt. Royal Ave., Baltimore 17, Md.	98
Ben Cohen, 1229 Mt. Royal Ave., Baltimore 17, Md.	1
Herman Cohen, 1229 Mt. Royal Ave., Baltimore 17, Md.	1

(c) What is the source of funds invested in the business?

3. Give the following information relating to persons who hold, or are expected to hold, a financial interest in the enterprise:

Names and Addresses	Amt. of Int.
Same as 2. (b)	

4. Give the following information relating to persons who have advanced by loan, or otherwise, the capital invested in the business.

(Do Not Include Persons Named in No. 3 Above)

Names and Addresses	Amount
Fairmount Steel Corporation, 1229 Mt. Royal Ave., Baltimore 17, Md.	$500,000

JOINT EXHIBIT 47-AU
ORGANIZATION MEETING
May 22, 1958

* * * * * *

Thereupon the meeting recessed for a period of one half hour, and upon reconvening it was ascertained that during the aforesaid recess the original subscribers or incorporators, Doris E. Kuhn had assigned her subscription to one share of common stock in this corporation, to Ben Cohen and, Joyce B. Sencindiver, had assigned her subscription to one share of common stock in this corporation, to Herman Cohen, and Clarence E. Martin, Jr., had assigned his subscription to four shares of capital stock in this corporation to Louis Pondfield, and Doris E. Kuhn and Joyce B. Sencindiver, their subscription, each to two shares of common stock in this corporation, to Louis Pondfield, and each had authorized the Secretary of this corporation, when elected, to issue the same in accordance with the assignments aforesaid, in their respective places and stead, and all of said stock was present in person or by proxy.

Thereupon it having been ascertained that the permanent certificates for capital stock in this corporation, are not now available, and that Ben Cohen has subscribed to one (1) share of common stock, and that Herman Cohen, has subscribed to one (1) share of common stock and Louis Pondfield has subscribed to 98 shares of common stock of this corporation and that they are ready to pay for the same upon the issuance of the respective certificates therefor to them, upon motion it was unanimously.

Resolved that the officers of this corporation, when elected, issue to the said Ben Cohen, Herman Cohen and

Louis Pondfield, appropriate certificates of stock in accordance with their subscriptions, as aforesaid, when full payment has been made therefor.

Thereupon, upon motion duly made and seconded, the by-laws of this corporation were adopted and the Secretary was directed to insert a copy thereof immediately following the transcript of this meeting, in the minute book of this corporaton.

Thereupon, upon motion duly made and seconded, the following were unanimously elected as the Board of Directors of this corporation:

Ben Cohen
Herman Cohen
Louis Pondfield

such Directors to serve until their successors are elected and are qualified.

Thereupon, discussion was had relative to the lease contract between Ben Cohen, agent, and Helene W. Boyle concerning the lease by him on behalf of this corporation of certain properties in Charles Town District of Jefferson County, West Virginia, that had theretofore been used by the said Helene W. Boyle and Albert J. Boyle, deceased, in the operation and conducting of horse racing meets in said District and County; said lease agreement being laid before the meeting.

Upon motion duly made and seconded it was unanimously,

Resolved that the lease agreement between Helene W. Boyle and Ben Cohen, agent, acting on behalf of this corporation, dated the 20th day of May, 1958, and the supplemental agreement affixed thereto, dated the 22nd day of May, 1958, be and the same are, in every respect, hereby accepted, ratified, confirmed and approved by

this corporation, all acts of the said Ben Cohen, acting as aforesaid, be and the same are hereby ratified, confirmed and approved by this corporation, and that all obligations and rights thereunder, be and the same are hereby, assumed by this corporation, without recourse upon the said Ben Cohen.

Thereupon, a discussion was had relative to the financing of the racing meeting provided for under the lease agreement aforesaid.

Upon motion duly made and seconded, it was unanimously

Resolved that the Directors and Officers of this corporation, enter into and execute such loans, agreements and obligations on behalf of this corporation, as necessary in order to provide for and conduct a horse race meeting on the properties leased by this corporation as aforesaid.

Thereupon a proposed contract between this corporation and Fairmount Steel Corporation, having been read to the meeting, discussion was had upon the same, and thereupon on motion duly made and seconded, it was unanimously

Resolved that this corporation enter into such contract with Fairmount Steel Corporation, that the appropriate officers of this corporation, when elected, execute the same on behalf of this corporation, and a copy thereof be placed in the files of this corporation.

Thereupon, upon motion duly made and seconded, the meeting was adjourned to meet at the call of the President.

Clarence E. Martin, Jr.,
Chairman.

Doris E. Kuhn,
Secretary.

[JOINT] EXHIBIT 49-AW

October 22, 1958

A special meeting of the Board of Directors of Charles Town Incorporated was held at the offices of the corporation, 1229 Mt. Royal Avenue, Baltimore, Maryland, on October 22, 1958, at 10:30 o'clock A.M. Those present were: Mr. Ben Cohen, Mr. Louis Pondfield and Mr. Herman Cohen, being all of the Directors of the corporation. Mr. Ben Cohen acted as chairman of the meeting and appointed Mr. Herman Cohen to act as Secretary.

* * * * * * *

Resolved, that the salary of Louis Pondfield, General Manager and Vice President of the corporation, be and hereby is determined to be $25,000 for the fiscal year ended November 30, 1958; and be it

Further Resolved, that the salary of Ben Cohen, President of the corporation, and Herman Cohen, Secretary and Treasurer of the corporation, be and hereby is determined to be $7,500 each; and be it

Further Resolved, that the Treasurer of the corporation be and hereby is authorized and directed to pay the said salaries to the respective officers on or before November 30, 1958.

The meeting then discussed the future operations of the corporation. Mr. Ben Cohen stated that Fairmount Steel Corporation is negotiating for a lease for the 1958-59 winter season at Charles Town and stated that, in the event that Fairmount Steel were successful in

obtaining the said lease, it would be willing to enter into a new agreement with Charles Town Incorporated for the operation of the Charles Town Race Track operations of the Fairmount Steel Corporation, said agreement to embody essentially the same terms and conditions as the agreement under which the operations were conducted during the summer season of 1958. Mr. Pondfield stated that, in his opinion, the summer season was very beneficial to the horsemen and the community of Charles Town, and he believed that if Fairmount Steel Corporation could negotiate another lease, he could continue to build up the good will among the patrons of the track. Mr. Ben Cohen then stated that Fairmount Steel Corporation would consider the agreements at its next meeting, and in the event that the Board of Directors would approve same, he would advise them that Charles Town Incorporated would undertake the management of the track during the winter season of 1958-59.

There being no further business, the meeting was adjourned.

Respectfully submitted,

Herman Cohen, Secretary.

Approved: Ben Cohen
Lou Pondfield

[JOINT] EXHIBIT 50-AX

November 12, 1958

A special meeting of the Board of Directors of Charles Town Incorporated was held at the offices of the corportion, 1229 Mt. Royal Avenue, Baltimore, Maryland, on November 12, 1958, at 10:00 o'clock A.M.

Those present were: Mr. Louis Pondfield, Mr. Herman Cohen and Mr. Ben Cohen. Mr. Ben Cohen acted as chairman of the meeting and appointed Mr. Herman Cohen to act as Secretary.

Mr. Ben Cohen reported that he consummated a Lease with Mr. [Mrs.] Albert J. Boyle for the winter season of 1958-59, and that he signed the lease on behalf of Charles Town Incorporated for this Meet. He further reported that Fairmount Steel Corporation paid to Mrs. Boyle $63,250 and deposited in escrow an additional check of Fairmount Steel Corporation for $224,250, guaranteeing to Mrs. Boyle the minimum rent for a Race Meet to be conducted sometime between December 15, 1958, and February 20, 1959; and that Fairmount Steel would enter into a contract with Charles Town Incorporated for the latter to conduct the Meet under the same terms and conditions as Charles Town Incorporated conducted the Meet for Fairmount Steel Corporation in the summer of 1958.

Upon motion made by Mr. Pondfield and seconded by Mr. Herman Cohen, it was unanimously agreed to enter into the same contract with Fairmount Steel

Corporation to conduct the Meet during the 1958-59 winter season as the previous contract, and Fairmount Steel Corporation is to provide Charles Town Incorporated with bankroll and any other money necessary for Charles Town Incorporated to conduct this Meet.

There being no further business, the meeting was adjourned at 11:15 o'clock A.M.

Respectfully submitted,

Herman Cohen, Secretary.

Approved:

Ben Cohen
Louis Pondfield

[JOINT] EXHIBIT 66-BN

West Virginia Racing Commission
Charleston 5, West Virginia

May 21, 1958

Honorable Clarence Martin
Attorney at Law
Martinsburg, West Virginia

Dear Clarence:

Bill Poland called me last night and told me that he had actually seen Mrs. Boyle sign a lease to the outfit which runs Pimlico, and that you represent them in this transaction. He said he had an application for dates from them to operate Charles Town from June 6 through September 1, and that there is a provision in the lease which permits the horse show to operate. I

asked him to get in touch with you so that we may know when the horse show will operate.

I am sending you five copies of "Supporting Statement to Application for License," asking that, after execution, you return four copies—one directed to our office in Charleston, one to me, one to Malcolm Lowe, and one to Bill Poland.

* * * * * *

I understand that Mr. Pondfield will be the manager, and I am enclosing herewith a letter directed to him, and ask that you turn it over to him at the proper time. As you will note, the letter names the officials whom we will appoint for this meeting.

* * * * * *

Very truly yours,

James G. McClure, *Chairman,*
West Virginia Racing Commission.

JGMcC: ew
cc: Mr. Wllam Poland
Mr. Malcolm Lowe

* * * * * *

In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 265

CHARLES TOWN, INCORPORATED, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

Section 482 of the Internal Revenue Code of 1954 confers discretionary authority upon the Commissioner of Internal Revenue to allocate income between two organizations which are controlled directly or indirectly by the same interests, if such allocation is necessary to prevent evasion of taxes or to reflect clearly the income of such organizations. Pursuant to that authority, the Commissioner here determined that taxpayer-petitioner (Charles Town) and Fair-

mount Steel Corp. (Fairmount) were controlled by Ben and Herman Cohen and that income reported by Fairmount from the operation of two horse-racing meets in 1958-1959 should be taxed to Charles Town. The Tax Court, sustaining the action of the Commissioner, found that "the total net income derived from the operation of the two racing meets in question was produced and earned by Charles Town." (Pet App. 52.) The Court of Appeals for the Fourth Circuit affirmed (372 F. 2d 415).

The decision below is correct and there is no conflict of decisions or any other basis for further review by this Court.

1. In early 1958, Ben and Herman Cohen, the operators of several enterprises including Pimlico Race Course, Baltimore, Maryland, were negotiating to purchase the Charles Town Race Course from the owner, Mrs. Helen Boyle. In May 1958, while the negotiations were in progress, the West Virginia Racing Commission advised Mrs. Boyle that she would lose her franchise if a summer meet was not held. Ben Cohen then began negotiations to lease the track and on May 20, 1958, a lease was entered into between Mrs. Boyle and "Ben Cohen acting for Charles Town Incorporated, a corporation hereinafter to be created." Charles Town, Inc. was incorporated on May 22, 1958, with Ben Cohen as its president, Herman Cohen as Secretary-Treasurer and Louis Pondfield, a cousin of the Cohens, as Vice President. One hundred shares of $10 par common stock were issued, with the Cohens each receiving one share and the remaining 98 shares going to Pondfield.

To provide the necessary capital for the operation of the meet, Housing Engineering Corporation, a corporation controlled by the Cohens, turned over $900,000 to Fairmount, another corporation controlled by the Cohens, and Fairmount then contracted with Charles Town to advance all monies necessary for the operation of the race meet in return for 90% of the profits. The advances made by Fairmount were in two series—$479,025 for the summer meet and $507,500 for the winter meet—each series being repaid in full by Charles Town within a few months. The profits distributed to Fairmount were $497,833.02 in 1958 and $234,466.84 in 1959. (Pet. App. 21-27, 37, 51.)

This round-robin would defy explanation but for the fact that Fairmount had allowable net operating loss carryovers from prior taxable years totaling $852,105.37. (Pet. App. 32.) By channeling 90% of the profits to Fairmount, where the income from the racing meets conducted by Charles Town would be offset entirely by the above-described income tax deductions, the Cohens hoped to avoid paying any income tax on the racing operation.

This case obviously presents the kind of manipulation which Section 482 was designed to combat. Taking into account the fact that Charles Town owned the lease of the racetrack property, obtained the requisite license and insurance, hired all the employees and paid all the bills (Pet. App. 35-45)—in contrast with the mere paper connection Fairmount had with the actual operation—it is clear that in any practical frame of reference, Charles Town earned the income

and should pay the tax on such income. *National Carbide Corp.* v. *Commissioner*, 336 U.S. 422. The anticipatory assignment of income to Fairmount is ineffective to shift the tax from the entity which earned it. *Lucas* v. *Earl*, 281 U.S. 111, 114-115.

2. In Section 482, Congress used the phrase "direct or indirect" to describe the kind of control sufficient to make that provision operative. It also refrained from defining control in terms of stock ownership. Thus, Congress made plain that the existence of common control of two or more organizations is to be determined in economic terms rather than by any set rule or formula. Consistent with the terms of Section 482, the term "controlled" has been defined as including "any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise." Section 1.482-1(a)(3) of the Treasury Regulations on Income Tax (1954 Code). In examining the facts and circumstances of the case, including the course of events which led up to the formation of petitioner, the courts below have followed, rather than misapplied, the statutory directive.

There is no merit to petitioner's contention that Section 482 is unconstitutionally vague because the term control is not precisely defined. It has long been recognized that Congress intended to give the Commissioner broad power to deal with the economic realities of particular situations. *Spicer Theatre, Inc.* v. *Commissioner*, 346 F.2d 704 (C.A. 6); *National*

Securities Corporation v. *Commissioner*, 137 F.2d 600 (C.A. 3). As this Court noted in *American Power and Light Co.* v. *Securities and Exchange Commission*, 329 U.S. 90, 105:

> The legislative process would frequently bog down if Congress were constitutionally required to appraise beforehand the myriad situations to which it wishes a particular policy to be applied and to formulate specific rules for each situation. Necessity therefore fixes a point beyond which it is unreasonable and impracticable to compel Congress to prescribe detailed rules; it then becomes constitutionally sufficient if Congress clearly delineates the general policy, the public agency which is to apply it, and the boundaries of this delegated authority.

See also *Hampton & Co.* v. *United States*, 276 U.S. 394.

3. Petitioner's assertion that the instant case conflicts with *Rooney* v. *United States*, 305 F. 2d 681 (C.A. 9), is unsound. Assuredly, *Rooney* stands for the proposition that common control must exist at the time "when the taxpayers deal with each other," but that standard clearly was applied by both courts below in this litigation. As pointed out by the court of appeals, the Cohen brothers "controlled the negotiations and entire course of events which led to the creation of Charles Town, the acquisition of the lease for the Race Course, and the execution of the agreement between Fairmount and Charles Town assuring essential capital for the new corporation and their continued control of the business venture." (Pet. App.

10.) Petitioner's main argument is that the courts below did not afford critical significance to the fact that Louis Pondfield, a cousin of the Cohens, formally owned 98% of its stock. In view of the fact that Pondfield's 98% ownership represented an investment of $980, whereas a total of $986,525 was advanced to Charles Town through the corporations controlled by the Cohens, the courts below quite properly rejected petitioner's argument that the Cohens "controlled" petitioner only through the written contracts which it entered into with Fairmount. In the perspective of economic reality the control of petitioner by the Cohens was manifest, including control at the time when petitioner and Fairmount "dealt with each other."

4. Similarly, petitioner mistakenly contends that this case is inconsistent with *Davis* v. *United States*, 282 F. 2d 623 (C.A. 10), which indicates that a Section 482 allocation cannot be made if the division of income made by the parties is the same as it would have been if they had dealt with each other at arm's length. (Pet. 9-10). The transactions involved in this case bear no resemblance to an arm's-length agreement and the Tax Court found that the amounts advanced by Fairmount to Charles Town were in the nature of an equity investment. Since an investor can not agree to divide taxable income with the corporation, see *Lucas* v. *Earl*, *supra*, it was quite properly concluded that the entire earnings of Charles Town should be included in its taxable income. See *National Carbine Corp.* v. *Commissioner*, *supra*.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

THURGOOD MARSHALL,
Solicitor General.

MITCHELL ROGOVIN,
Assistant Attorney General.

GILBERT E. ANDREWS,
ALBERT J. BEVERIDGE, III,
Attorneys.

JULY 1967.

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IN THE

Supreme Court of the United States

October Term, 1967

No. 265

CHARLES TOWN, INCORPORATED,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S REPLY TO MEMORANDUM FOR THE RESPONDENT IN OPPOSITION.

It is noteworthy that while respondent, in his Memorandum in Opposition, uses four numbered points to respond to petitioner's four numbered reasons for granting the writ, he changes the order and wholly omits any response whatever to petitioner's Reason 3. Even as to the other three reasons given by petitioner respondent's memorandum is not actually a response; it is a confession. As it will be seen, his contentions are in conflict with his own authorities.

We shall take respondent's four points in their order.

1. In order to connect Fairmount's advances to petitioner with a sum Fairmount had previously received from Housing, respondent persists in trying to add the advances for the two racing meets together (Mem. 3), despite the simple arithmetic showing that Fairmount's advances for the first racing meet were

repaid in full before any step looking toward a second meet was taken. (Pet. 6, fn. 4.) We consider this effort of respondent's irrelevant, however, because the issue of allocation here is not between Housing and Fairmount, but between Fairmount and petitioner. If respondent desired to contend that the income received by Fairmount belonged to Housing, that would be another case. Surely the furnishing of half a million dollars for each meet, whether the source was Fairmount or Housing, was no "mere paper connection," as respondent attempts to say (Mem. 3).

2. Respondent implies (Mem. 4-5) that Congress gave him the power to determine, without limitation, whether common control existed in a particular situation. The broad authority given respondent under Section 482 of I.R.C. 1954 is to allocate "In any case" where common control exists; the broad authority given him there does not include determination as to *whether* such control exists. In none of the cases which respondent cites, moreover, was the issue of common control presented.

In the two tax cases cited by respondent, *Spicer Theatre, Inc. v. Commissioner*, 346 F.2d 704 (C.A. 6), and *National Securities Corporation v. Commissioner*, 137 F.2d 600 (C.A. 3), the only power granted by Congress considered was the power to make the required allocation. In each the common control was based upon ownership; in *Spicer* all the common stock of both corporations was owned by an individual and his wife, and in *National Securities Corporation* the two corporations involved were parent and wholly owned subsidiary. In the non-tax cases cited by respondent there is the same effect. In *American Power and*

Light Co. v. Securities and Exchange Commission, 329 U.S. 90, involving the Public Utility Holding Company Act, the two entities involved were two subholding companies in a single holding company system; the power granted by Congress at issue was only the power to determine whether the system structure was unduly complicated, or unfairly distributed voting power. And in *Hampton & Co. v. United States*, 276 U.S. 394, there was but one entity; the determination to be made was the tariff necessary to equalize the domestic and foreign cost of a particular, specified product, barium dioxide.

In *American Power and Light Co.*, moreover, it was held that, as quoted by respondent himself (Mem. 5), Congress cannot delegate authority without stating the *boundaries* of the delegated authority. Of course, every person who furnishes the money for a venture is able to demand and exercise a large measure of control in respect to it. Indeed, many banks, solely because of their money, are able to exercise strong control over their borrowers.

Here, if respondent really had been given by Congress the broad power to determine whether in any given situation common control existed, what were the boundaries of that power, as stated by Congress? There were no such boundaries stated. On that basis alone, the provision, as respondent here would interpret and apply it, would be invalid.

3. Respondent in attempting (Mem. 5) to distinguish *Rooney v. United States*, 305 F. 2d 681 (C.A. 9), in effect admits that he cannot distinguish it. He says there that the Cohens controlled, among other things, "the execution of the agreement between Fairmount and

Charles Town assuring essential capital for the new corporation and their continued control of the business venture."

Of course, the agreement assured no such continuing control since by its express terms, repeated again and again, it applied only to *the* racing meet (Pet. App. 30-32; pars. 1, 2, 3, 5, 8, 10), a meet to run for a period of less than four months, precisely described, by beginning and ending dates, at the very outset of the agreement (Pet. App. 30, par. 1). And respondent's reference to the agreement, especially to the fact that it *assured* the essential capital, shows his reliance upon the agreement as the basis of control.

Now that agreement came into legal existence when petitioner, at its organization meeting, and after Pondfield had subscribed to 98 per cent of its stock (Pet. App. 81), ordered the execution of the agreement (Pet. App. 83). That meeting, at the time of such order, was thus under the control of Pondfield as the subscriber for the majority of the shares subscribed for. Fletcher Cyclopedia Corporations, Ch. 44, §3756, at fn. 15, Ch. 13, §2027, at fns. 11, 12.[1] Clearly Pondfield was in control of petitioner at the critical point at which that corporation became legally a party to the agreement. Clearly then the decision below is in direct conflict with the Ninth Circuit in *Rooney, supra.*

4. In his attempt to distinguish *Davis v. United States,* 282 F. 2d 623 (C.A. 10), respondent (Mem. 6) volunteers the idea that the transactions involved bear no resemblance to an arm's length agreement.

[1]Neither the West Virginia Code nor the corporate charter of Charles Town, Joint Exhibit 47-AU, Pet. App. 81-83, summarized at Pet. App. 24, contains anything to the contrary.

There is no finding, nor any evidence, to support this, and respondent points to none. Respondent then says that the Tax Court found that the amounts advanced by Fairmount were in the nature of an equity investment. They were an equity investment, indeed, but in a venture, precisely described and to be carried out during a very short and specifically stated calendar period. First there was one such venture, and subsequently, under a completely new and separate agreement, a second, and then no more. For that very reason there could be no finding, and there is none, that the amounts advanced by Fairmount were an equity investment in petitioner, *Charles Town, the corporation.*

Moreover, under each of the two agreements Fairmount undertook the burden of furnishing "all monies necessary" for the operation of the meet, and of bearing entirely any loss. Respondent emphasizes the first of these burdens by referring to the agreement's "assuring" the essential capital (Mem. 5). Because of these burdens Fairmount clearly could not assign its interest under either agreement, as it could stock. 6 CJS 1073-4 (Assignments §25).

Respondent correctly states here, furthermore, that an investor cannot agree to divide taxable income with the corporation. This in itself is an admission that Fairmount was not an investor in Charles Town, the corporation, but only in the venture for which the agreement between them provided.

Nor can respondent, as he does here, rely upon the agreement and attack it at the same time. Respondent relies, as he must, upon the agreement to show control. He wholly fails to show that without the agreement in each case the Cohens would have had any

control over the racing meet involved. He is in no position therefore to challenge its division of income. 17A CJS Contracts, §297, giving several pages of supporting citations, including *Wood Coal Co. v. Little Beaver Mining Corp.*, 116 S.E. 2d 394, 397, 145 W. Va. 653, and *Miller v. Robertson*, 266 U.S. 243, 251. Respondent's attempt to distinguish *Davis* has no validity whatever. Clearly the decision below is in direct conflict with the Tenth Circuit in the *Davis* case.

Conclusion.

Finally, we point out again that respondent makes no attempt whatever to respond to our Reason 3 (Pet. 10-12).

We submit in conclusion that the petition for a writ of certiorari should be granted.

GEORGE T. ALTMAN,
Attorney for Petitioner.